

Global Leadership

Embracing Change: The healthcare industry focuses on new growth drivers and leadership requirements

This special report from Russell Reynolds Associates is the second in an ongoing series that examines the complex challenges facing the global healthcare industry. This paper addresses innovation and leadership issues in Pharmaceutical and Biotech organizations.

Our first discussion—entitled Insights from the CEO/Innovators Roundtable: Healthcare in High Gear—examines the regulatory, payment reform and service delivery issues facing Health Services organizations.

The healthcare industry is in the midst of a turbulent global transformation. Healthcare reform and fiscal restraint are front and center on the minds of politicians, the media and business leaders around the world. As the global healthcare industry grapples with an unsustainable cost trajectory, it also is facing increased demand for healthcare services by an expanding pool of consumer-patients and by growth in costly chronic disease management. Global healthcare costs, currently estimated at \$6 trillion to \$7 trillion, are projected to reach more than \$12trillion within just seven years. Given this outlook, radical measures are expected to be taken to control this spiraling expense.

In the United States, healthcare spending now represents 17 percent of gross domestic product (GDP), and, amidst a modest economic recovery, healthcare costs are expanding at twice the country's economic growth rate. In Europe, beset with its own economic challenges and where single-payer systems are the norm, healthcare costs also are climbing unsustainably beyond national and regional growth rates. According to the Organisation for Economic Co-operation and Development (OECD), healthcare spending represents an average of 9.5 percent of GDP for the 34 OECD countries in North and South America, Europe and the Asia/Pacific region. The average annual growth rate in healthcare costs for the group is 4.9 percent (exceeding the U.S. rate). In China, where most of the country is insured, healthcare spending is growing at a rate of 16 percent. The global phenomenon, regardless of payer system, is that the pool of available capital to pay for healthcare is either decreasing or staying flat, while costs are rising. The pharmaceutical sector, where overall revenue is expected to remain flat or to decline over the next 10 years, is a reflection of this new reality.

Despite these economic indicators, innovation and digital transformation may offer solid solutions for increasing the quality of care while containing costs—but only if executed properly. Additional competitors from outside the traditional healthcare sphere, including many from the technology sector, are seeking to enter the healthcare market. These competitors are not only eager to

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capture some of the healthcare revenue, but they are familiar with operating in an endless cycle of aggressive competition, product development and innovation. They also are accustomed to functioning in an environment where companies can be completely disintermediated from consumers in a matter of months. This constant state of reinvention and transformation is a relatively recent one for healthcare, but it's one that's here to stay.

“R&D organizations in pharma have gone through significant change, and this change will continue.”

“Big pharma will create more virtual R&D structures and will focus on fewer specialty areas.”

“Only those companies that are true innovators will survive.”

In reaction, senior-level leaders of pharmaceutical and other healthcare products companies are focusing their strategies on new drivers to reposition their companies for growth. We recently surveyed a cross section of board members and chief executives from healthcare organizations across Europe—primarily product side organizations in pharmaceuticals, biotech and medtech but also some healthcare services—about how their organizations were positioned for transformation and the challenges ahead. We asked these leaders a series of questions about where they saw growth opportunities emerging, which business functions were likely to undergo the most transformation in the upcoming period, the role of technology in the future of their business and more. Amidst a range of answers, four key opportunities or trends stood out:

1. Innovation, Not Diversification
2. Integration of Medicine and Healthcare—Digitally Accelerated
3. Redefinition of Market Access
4. The Patient at the Center

1. Innovation, Not Diversification

How companies will respond to the tremendous macro change taking place in the healthcare sector today, of course, is the key question. In our survey, only 20 percent of board members and CEOs felt that further diversification—such as expanding into generic medicine or into fields such as animal health—would be a crucial growth driver in the next three to five years. The vast majority of respondents—the other 80 percent—believed growth will be fueled by activity around innovation, mergers and acquisitions, and new geographic markets.

As the product side of the healthcare industry adapts to the reality of major patent expirations on the horizon and fewer blockbuster solutions in the product pipeline, companies have implemented a number of initiatives to address the issue of innovation. The dominant focal point to date largely has been defensive such as restructuring research and development (R&D) organizations into smaller and more independent units and redesigning processes to be more efficient and effective. This direction is expected to continue. In fact, every respondent indicated that they expect the R&D function to undergo adjustments over the next five years—and nearly two-thirds expect the extent to be significant.

The fundamental change afoot is the shift toward more virtual R&D models. But what will they look like? And will that be enough? Many of these solutions leverage digital advances and likely will include computer modeling on virtual patients and molecular-level biosimulation that could shrink the product development timeline. These virtual R&D models also should enable the targeting of diseases not treatable through mass market blockbuster solutions. It is within this framework that our clients are beginning to think beyond making their organizations more efficient and to determine how top management can structure and lead an organization that embraces and cultivates a culture of efficient and effective innovation. Clearly, the profile of

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the successful R&D leader will continue to evolve toward a greater emphasis on business acumen, cross-functional experience and entrepreneurial drive—a trend identified in our previous publication *Heterosis*.

On the offensive side, companies are increasingly leveraging external opportunities, including buying assets and, critically, partnering with others. For example, pharmaceutical companies are building their own venture funds, at once taking risks on new solutions but also forming early partnerships with fledgling organizations. Other important possibilities in this category include alliances with academic institutions; pre-competitive activities such as basic cooperative research that builds partnerships; and strategic mergers and acquisitions. Those companies that implement such solutions and that embrace a broad range of innovation options will be positioned to advance beyond the competition.

As a result of these trends, our survey respondents also suggested a need to upgrade business development functions and to produce more creative deal structures. By way of example, one leader noted the need to “engage biotech [professionals] and treat them as a supplier of innovation.” Specifically, 63 percent of these leaders expect to see at least some adjustments in business development organizations in the next five years, with 38 percent predicting significant change.

“Constant new product development is THE key growth driver, but R&D productivity is unacceptably poor so new approaches to R&D must be employed.”

“The pharmaceutical industry will access more external capability for innovation, including in emerging markets, Europe and the United States.”

2. Integration of Medicine and Healthcare—Digitally Accelerated

The pharmaceutical industry, healthcare providers and regulatory bodies historically have led almost separate—but parallel—lives. Pharmaceutical companies previously concentrated on launching blockbuster drugs, while healthcare providers focused their energy on providing patient care. Arguably, neither was intensively concerned about building relationships with the market shapers: governments and payers. Today, these ecosystems are converging, and the goal is collaboration: The solution lies within the supplier-customer relationship.

As a result of the converging ecosystems, stakeholder groups now form an organized and connected web from patients through to payers (see figure). This interconnectedness has created a new reality that is aligned with a holistic approach to healthcare. This modern context, which also has been described as the “democratization of healthcare,” poses a suite of different strategic challenges for the pharma players that affects virtually all functional and business areas. From a leadership perspective, broad skills and attitudes will be required to manage a more collaborative and integrated approach to health management. By definition, this extends to integrating skills and competencies across pharmaceuticals, device and delivery systems, and technology.

Digital healthcare will be a key accelerator of this trend across all parts of this converging ecosystem. For example, product innovations in development will lead to digestible microchips that can monitor vital signs and alert physicians if patients have quit taking their medicine. Not only can this improve the quality of care by ensuring medical compliance, but such compliance will reduce costs by keeping patients out of the hospital.

Large-scale data analysis—in which clinical data and claims data can be integrated for entire patient populations—also can change the value proposition of healthcare. This analysis will allow

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providers to determine the sickest patients and will enable real-time, real-world analysis about the effectiveness of certain medications on entire patient populations.

On the consumer side, the digitalization of healthcare will be enormously powerful and empowering. This will manifest itself in new tools for physicians and consumers to communicate with each other outside of doctors' offices. Through social media platforms and rating sites, consumers effectively will drive costs down by sharing experiences regarding fees and quality of physicians, hospitals and procedures.

Change and innovation in healthcare historically has been an evolutionary process, not a revolutionary one. Yet these converging ecosystems, enabled by technology, will dramatically reshape the industry.

Partners in Health Management



3. Redefinition of Market Access

Particularly on the product side of the industry, the demand for value, combined with increased regulatory hurdles and intensified requirements for clinical relevance, has shifted the emphasis from the development of approvable drugs to approvable and reimbursable drugs. Returning capital to shareholders also remains an important area of focus.

In our recent work with senior-level pharma leaders, there is a clear trend and pressure toward creating more sophisticated market access strategies and the organizations necessary to deliver them. For example, pricing models now are factored in much earlier in the development process. And, in some cases, scientific liaison teams have replaced the traditional salesforce when it comes to supporting new products.

Not surprisingly, respondents to our survey felt their biggest leadership gap in the coming few years would be with their market access leadership teams. Where might the future leaders come from? Forty-seven percent of our poll thought sales and marketing functions would be a good source of talent, as would commercially oriented executives with a medical background. Given the increasing need for market access to effectively face and influence internal and external stakeholders throughout a product's life cycle, these leaders will need a broad set of competencies, including innovative thinking, excellent analytical proficiencies, high-level strategic vision and finely tuned influencing skills. This runs against the grain of many of the talented but commercially naïve technical experts the industry traditionally has cultivated.

“Market access is becoming increasingly critical in this environment as it is becoming dominated by cost constraints and healthcare spending.”

4. The Patient at the Center

Both the downward pressure on pricing through restricted healthcare budgets and the requirement to demonstrate cost-effectiveness are driving significantly different purchasing behaviors within the industry. As a result, drug companies' existing commercial models also are being challenged. In our survey, nearly 70 percent of the respondents commented that the sales and marketing organizations are likely to evolve further in the coming years. As one of our surveyed executives put it, "Sales and marketing today are extremely inefficient processes, and with the pressure on reimbursement, the industry needs to find new models of selling and distributing products."

Indeed, the consensus was that the commercial model is evolving away from a direct salesforce model toward one where multidisciplinary teams set about to educate and influence a broader set of stakeholders, including key opinion leaders, payers, hospitals and group purchasing organizations. Patient and their health management issues will take center stage in this evolving process. The expectation is that today's sales and marketing organizations will become increasingly integrated across marketing, market access and key account management. New leaders, many from outside the industry, will bring unique experience and perspectives to bear; for example, with cost-risk sharing models and virtual patient communities. To this end, some of our clients are establishing the role of chief patient officer in order to focus the go-to-market strategy on patients and their health management needs (as well as the financial demands of the other stakeholders in the system).

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Embracing New Talent and Leadership Profiles

The current survey highlights a broad industry convergence around four key trends and growth drivers: innovation, health management, strategic market access and patient centricity. Importantly, each of these areas has significant implications regarding tomorrow's leadership requirements. At the highest level from chairman to CEO to functional leadership, managers must bring unprecedented strategic vision and an appreciation of the latest ideas and business models. The old ways of doing business simply won't work in the future of healthcare, and boards and leaders need to be prepared to find people with cross-functional skills and expansive career development. Organizations also will need to look outside their traditional sources to secure talent with the right skills for this rapidly evolving sector. The marketplace, especially for leaders with digital experience and mindset, particularly is competitive and will remain so for years to come as other industries also are seeking to identify people with these same skill sets.

The emergence of modern types of leadership roles should be considered a key opportunity to address the changing industry dynamics. In order to drive value for all stakeholders, our most progressive and proactive clients are implementing entirely new leadership roles in the form of chief digital officer, chief patient officer, head of payer strategy and more.

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