

Issues Monitor

Sharing Knowledge on the Pharmaceuticals Industry

KPMG INTERNATIONAL

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Welcome to the July edition of *Issues Monitor*. Each edition pulls together and shares our firms' industry-wide knowledge to help you quickly and easily get briefed on the issues that effect your sector.

John Morris

Global

Pharmaceuticals Chair



Keeping up to date with the very latest and most pressing issues facing your business can be a challenge and, while there is no shortage of information in the public domain, filtering and prioritizing the knowledge you need can be time consuming and unrewarding. I hope that you find *Issues Monitor* useful and welcome the opportunity to further discuss the issues presented and their effect on your business.

ISSUE 1: M&A in the global pharmaceuticals and biotechnology sectors

The pharmaceuticals and biotechnology sectors are increasingly turning to mergers and acquisitions (M&As) to address the various challenges they are facing — the spate of large mergers in early 2009 stands testimony to that. However, as we move into the second half of 2009, it remains to be seen whether the sectors continue to engage in mergers of that scale or settle for smaller, but more strategic deals.

ISSUE 2: The changing landscape of the pharmaceuticals sales force

Today's pharmaceuticals sales force faces an increasingly challenging environment. Decreased access to physicians and curbs on promotional options, among others, render the traditional sales force strategies ineffective. To counter these challenges, pharmaceutical companies are now adopting various measures including sales force restructuring and utilization of digital tools. Adoption of these strategies will pave the way to efficient and effective pharmaceutical sales force teams in the future.

ISSUE 3: IT outsourcing in pharmaceuticals

With the growing adoption of Information Technology (IT) in the pharmaceutical industry, IT outsourcing is emerging as a key business strategy. Outsourcing of non-core functions such as IT applications, IT infrastructure and systems integration allow pharmaceutical companies to focus on core competencies. Challenges notwithstanding, the industry continues to outsource IT functions to save costs as well as to drive efficiencies in business processes.

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M&A in the global pharmaceuticals and biotechnology sectors

The pharmaceuticals and biotechnology sectors are currently battling with declining pipelines, patent expirations and a clampdown on healthcare spending. As their troubles grow, the sectors are being forced to increasingly engage in mergers and acquisitions (M&A) activity. While the increased M&A activity in the sectors is not expected to cool down any time soon, what remains to be seen is whether the sectors will continue along the path of the recent large-scale M&As or will focus on smaller and more strategic deals.



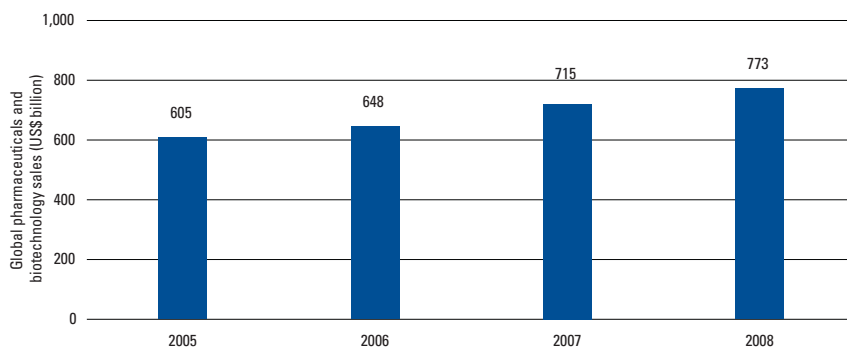
In 2008, the global pharmaceuticals and biotechnology prescription drugs sales grew

4.8%, the lowest rate since 2001.

Global M&A review: The return of megamergers

In 2008, global pharmaceuticals and biotechnology prescription drugs sales grew 4.8 percent, the lowest rate since 2001.¹ Sales growth is expected to be even lower in 2009, at 2.5 – 3.5 percent.² Along with this slowdown, the pharmaceuticals sector is faced with an increasingly challenging environment resulting from increasing patent expirations, growing generic sales, reducing new drug pipelines and stricter regulations. The biotechnology sector also faces increased regulatory challenges as well as shortage of credit.

Figure 1: Global pharmaceuticals and biotechnology sectors sales, 2005 – 08



Source: Global Pharmaceutical Sales 2001 – 2008, IMS Health, March 2009

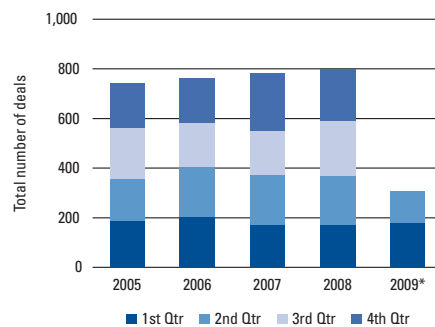
The 2009 megamergers of Pfizer and Wyeth, Merck & Co. and Schering Plough, and Roche and Genentech are clear examples of how the sectors are looking to M&A activity to overcome the current challenges. M&A activity can provide access to new products, invigorated research pipelines, markets and cost savings if synergies are achieved.

What factors are driving the increased M&A activity in the global pharmaceuticals and biotechnology sectors?

In the period from June 08 to May 09 (the current review period), the pharmaceuticals and biotechnology sectors have witnessed increased M&A activity, including some bick-ticket acquisitions, compared with the period of June 07 to May 08 (the previous review period). This has been possible largely because the sectors have the necessary internal resources and credit lines to finance such deals. Megamergers, which had been absent from the sectors since 2004, made a dramatic comeback in 2009. Pharmaceutical companies are looking to acquire more biotechnology products and companies as pharmaceutical drug sales slow. Pharmaceutical firms were also seen acquiring generic pharmaceuticals.

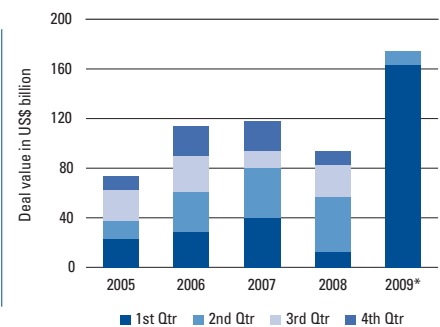
The global pharmaceuticals and biotechnology sectors saw only a 1.7 percent increase in the total number of deals in the current review period. However, the total disclosed value of deals increased by a staggering 185 percent, to US\$226.2 billion. Due to the three megamergers, valued at US\$155.9 billion, the average size of the deals increased from US\$164 million in the previous review period to US\$430 million in the current review period.

Figure 2: M&A in the global pharmaceuticals and biotechnology sectors – number of deals (2005 – 09*)



Source: Thomson One Banker
*January to May

Figure 3: M&A in the global pharmaceuticals and biotechnology sectors – value of deals (2005 – 09*)



Source: Thomson One Banker
*January to May

Americas dominate regional activity

The Americas accounted for 91.2 percent of the total deal value in the current review period. The volume of deals was the second highest ever with 287 deals, with a 271.4 percent rise in deal value. While the three megamergers were largely responsible for this increase, the region also witnessed many smaller multi-billion dollar deals from both foreign and local players. Glaxo-SmithKline, Roche and Teva were among the key foreign players targeting companies in the region.

Buoyed by the Pfizer and Wyeth, and Merck & Co. and Schering Plough megamergers, the value of acquisitions by companies in the region increased by 330 percent in the current review period. Total acquisitions by companies based in the Americas accounted for 60.3 percent of the total value of deals, unlike in the previous review period, when Europe/Middle East and the Americas had an almost equal share. Almost all the billion-dollar deals by companies in the Americas consisted of acquisitions of other local players.

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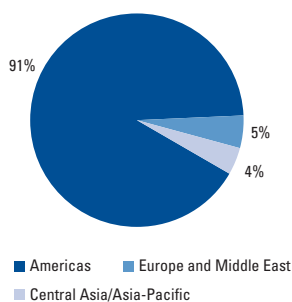


M&A activity targeting pharmaceutical and biotechnology companies in **Europe and the Middle East** region increased, in terms of deal value, by 36.6 percent in the current review period. Austria, the Czech Republic, Switzerland and the UK accounted for 54.5 percent of the total deal value in the region. Two deals of over a billion dollars were within the generic pharmaceuticals space, with Novartis acquiring the specialty generics business of the Austrian firm Ebewe Pharma and Sanofi-Aventis acquiring Czech firm Zentiva.

The value of acquisitions by pharmaceutical and biotechnology companies within the region increased by 158.2 percent to US\$80.7 billion. Roche’s acquisition of Genentech was the primary driver for the increased activity. GlaxoSmithKline, Novartis and Sanofi-Aventis were among the most active acquirers in the region, with all three acquiring multiple targets.

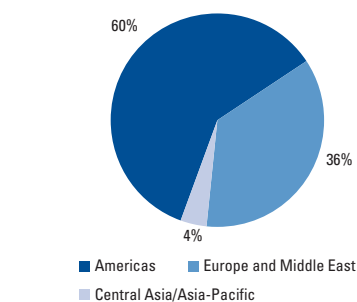
In the Middle East, Teva Pharmaceutical’s US\$7.46 billion³ acquisition of Barr Pharmaceuticals increased the deal value of acquisitions originating from the region.

Figure 4: Global M&As in the pharmaceuticals and biotechnology sectors by target region – June 08 to May 09 (by value)



Source: Thomson One Banker

Figure 5: Global M&As in the pharmaceuticals and biotechnology sectors by acquirer region – June 08 to May 09 (by value)



Source: Thomson One Banker

The total value of M&A deals targeting companies in **Central Asia/Asia-Pacific** decreased by 43.8 percent to US\$8.8 billion. This significant drop was due to decreased activity in Japan, where the value of acquisitions fell from US\$7.7 billion to a mere US\$87.1 million. However the global pharmaceuticals and biotechnology sectors’ interest in China and India continued to grow. These countries accounted for 146 and 38 deals, respectively, out of the 305 deals within the region. India emerged as the top target country in terms of deal value, as a result of the Daiichi-Sankyo’s US\$4.6 billion acquisition of Indian generics firm Ranbaxy Laboratories.⁴

The deal value of acquisitions by companies in the region decreased by 44 percent to US\$9.1 billion. Japanese pharmaceutical and biotechnology companies continued to be active acquirers, though their activity was focused on countries outside Japan. This signaled, the second consecutive period of increased outbound activity by Japanese companies, in which Daiichi Sankyo’s acquisition of Ranbaxy Laboratories and Shionogi & Co.’s acquisition of Sciele Pharma were most notable.



Acquisitions of Barr Pharmaceuticals, Ranbaxy Laboratories and Zentiva in the generic pharmaceuticals space amounted to **US\$14.66 billion.**

Why are pharmaceutical companies targeting generics makers?



With two large megamergers in the pharmaceuticals sector, pharmaceutical companies accounted for more than **91%** in the total deal value in the current review period.

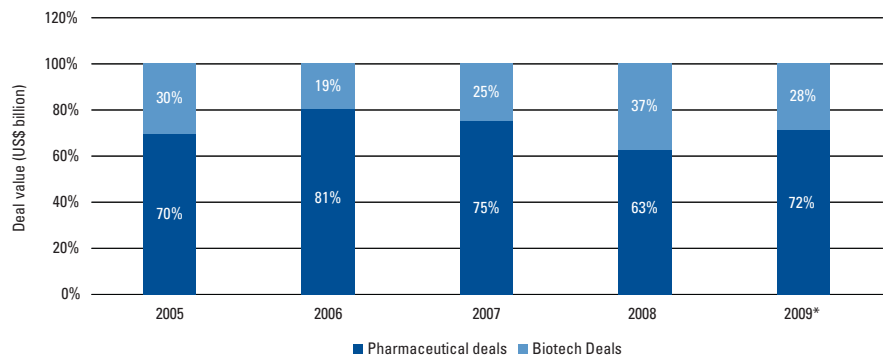


Analysis by sector

The total deal value in the **pharmaceuticals sector** increased by 181.2 percent to US\$160.5 billion. This increase was due to the two megamergers by Pfizer and Merck & Co., which accounted for 68 percent of the total deal value. The current review period was marked by significant activity in generic pharmaceuticals, with the acquisitions of Barr Pharmaceuticals, Ranbaxy Laboratories and Zentiva amounting to US\$14.66 billion,⁵ or 9.1 percent of the total disclosed deal value in the sector.

The number of deals in the **biotechnology sector** decreased by six percent, while the total value of these deals increased by 194.7 percent to US\$65.7 billion. Lower valuations and decreased activity by private equity (PE) companies have made small and mid-size biotechnology companies more attractive, although this has not translated into increased deal activity. At the same time, large deals such as Roche's acquisition of Genentech and Invitrogen's acquisition of Applied Biosystems provided a significant boost to the total deal value. Eli Lilly's acquisition of ImClone and Roche's acquisition of Genentech highlighted pharmaceuticals' continued interest in biotechnology companies.

Figure 6: Breakdown of global M&A value by sector (2005 – 09*)



Source: Thomson One Banker – as accessed on 11 June 2009
* January to May

Analysis by acquirer type: Cash-rich pharma goes on a buying spree

With two large megamergers in the **pharmaceuticals sector**, pharmaceutical companies accounted for more than 91 percent of the total deal value in the current review period. Deal value of acquisitions by pharmaceutical companies increased by 410.9 percent. Impacted by the economic crisis, financial institutions witnessed a fall in their share of total deal value, from 20.8 percent to 2.3 percent. The value of acquisitions by financial investors fell by 69.6 percent.

Table 1: Analysis of the total pharmaceuticals M&A deals by acquirer type (June 2008 – May 2009)

Acquirer type	Total disclosed value of deals (US\$ million)		Total percentage share	
	June 08 – May 09	June 07 – May 08	June 08 – May 09	June 07 – May 08
Pharmaceuticals	146,229	28,624	91.09%	50.14%
Financial investors	3,616	11,880	2.25%	20.81%
Biotechs	1,882	1,386	1.17%	2.43%
Others	8,813	15,199	5.49%	26.62%
Total	160,541	57,089	100%	100%

In the **biotechnology sector**, pharmaceutical companies continued to be active acquirers, with the deal value of acquisitions increasing 273.8 percent in the current review period. The major acquisition by a biotechnology company was Invitrogen's acquisition of Applied Biosystems. The deal value of such acquisitions increased by 267.6 percent. A significant fall was seen in deals by financial companies. The value of disclosed deals fell by 68.9 percent over the previous review period. The economic crisis has had a significant impact on PE-driven M&A deals in the biotechnology sector. With the slowdown in PE activity, small and mid-size biotechnology companies have been targeted by cash-rich pharmaceutical and biotechnology companies.⁶

Table 2: Analysis of the total biotechnology M&A deals by acquirer type (June 2008 – May 2009)

Acquirer type	Total disclosed value of deals (US\$ million)		Total percentage share	
	June 08 – May 09	June 07 – May 08	June 08 – May 09	June 07 – May 08
Pharmaceuticals	55,640	14,885	84.73%	66.80%
Financial investors	533	1,716	0.81%	7.70%
Biotechs	8,352	2,272	12.72%	10.20%
Others	1,140	3,409	1.74%	15.30%
Total	65,665	22,282	100%	100%



The three megamergers in Q1 2009 accounted for US\$155.9 billion, or 69% of the total deal value, in the period from June 08 to May 09.

Key deals

- In January 2009, Pfizer entered into a merger agreement with Wyeth valued at US\$68 billion. The deal is to be financed through a combination of cash, stock and debt. A consortium of banks will provide US\$22.5 billion for the M&A.⁷
- In March 2009, Roche acquired the remaining 44 percent of Genentech shares for an all-cash US\$46.8 billion deal. Prior to the deal, Roche raised US\$39 billion through bond sales.⁸
- In March 2009, Merck & Co. acquired Schering-Plough in a cash-stock deal worth US\$41.1 billion. The cash component includes US\$9.8 billion from Merck's cash reserves and US\$8.5 billion committed by JP Morgan Chase.⁹



Outlook: The path ahead — Megamergers or smaller strategic deals?

The megamergers of Q1 2009 have put pressure on other large pharmaceutical and biotechnology companies.¹⁰ Companies such as AstraZeneca, Bristol-Myers Squibb, Eli Lilly, Johnson & Johnson and Sanofi-Aventis may be the likely candidates for the next wave of consolidation.¹¹

The current environment and expectation point toward more large deals. However, the industry's experience shows that megamergers often do not produce the intended synergies, but rather tend to erode shareholder value, create major integration challenges, while not achieving improved new drug pipelines.¹²

However executives of several companies have indicated they will not join the megamerger bandwagon, and will instead rely on their own Research and Development (R&D) or enter into smaller partnerships or M&A deals.

- Andrew Witty, CEO of GlaxoSmithKline, intends to stay away from megamergers¹³ and expects to enter in more bolt-on acquisitions to add to its business in emerging markets and over-the-counter medicines.¹⁴
- Eli Lilly, Novartis and Sanofi-Aventis have also made their intentions clear about not entering into megamerger deals.¹⁵

"I think we are seeing deals that are really driven more by weakness than what I would describe as strong strategic combinations. They are predicated on synergies and rather massive cost-cutting. That will improve short-term problems but fail to answer the long-term question of research productivity."

– John Lechleiter, Chairman, President and Chief Executive Officer, Eli Lilly

It is still not clear whether the sectors are heading towards more megamergers of the scale seen in Q1 2009 or whether they will move towards smaller and strategic acquisitions. Deals in the biotechnology sector could increase further in 2009 as small and mid-size biotechnology companies become increasingly willing to enter into deals at value prices. Large pharmaceutical and biotechnology companies are scouting around for deals at much lower valuations, and the current trend of M&A in generics is one to watch for in the future.

FURTHER INFORMATION

How KPMG firms can help

Making Deals

No matter where in the world you operate, KPMG firms' 2,000 corporate finance specialists can help you weigh up whether an acquisition or deal is right for you. We have the knowledge and multiple years' experience to help you make successful acquisitions by developing a bidding strategy that can give you advantage over other interested parties.

Financing Deals

KPMG firms' corporate finance specialists can help you put in place financing structures that are designed to give leading returns. From drawing board to deal closure, we are committed to

ensuring that you get open and honest advice on financing, refinancing and releasing capital value.

Taxing Deals

KPMG's Global Mergers and Acquisitions Tax practice is a global team of focused tax professionals in over 65 member firms that specialize in Mergers and Acquisitions tax issues that arise from cross-border acquisitions, disposals and integration of target companies with the acquiring company. Progressive thinking can help clients with effective tax planning opportunities, and confidence that structures are implemented correctly and efficiently.

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The changing landscape of the pharmaceuticals sales force

What factors are forcing pharmaceutical companies to revisit their sales force strategies?

The decline of blockbuster drugs and the changing market environment have had an impact on the dynamics of the pharmaceuticals sales force. Given the current market climate and declining product pipelines, maintaining a large sales force is no longer sustainable. Decreasing physician access is also impacting the effectiveness of sales personnel. Pharmaceutical companies are looking to restructure their sales forces and are adopting new technologies and methods which provide their sales personnel with alternative means to access physicians. While some of these strategies may only be short-term solutions, others may well become sales models of the future.



According to a survey conducted by SK&A Information Services Inc, about one in four physicians works in a setup that does not permit visits by pharmaceutical sales personnel.

Access to physicians becomes more difficult

According to a survey¹⁶ released in February 2009, of the 640,000 physicians in 227,000 medical practice setups in the US, about one in four physicians works in a setup that does not allow visits by pharmaceuticals sales personnel. Further, 40 percent of those physicians who do entertain visits do so only with scheduled appointments.¹⁷

Sales representatives face the double challenge of not only having difficulty in accessing physicians, but also having shorter face-to-face interaction time. The most important of the criteria cited by physicians for assessing the value of a visit by sales personnel was for the sales representative to respect their time pressures, according to a TNS healthcare survey of physicians in France, Germany, Italy, Spain, the UK and the US (Figure 7).¹⁸ Due to time constraints, physicians are spending less time in direct interactions with sales reps. In 1982, pharmaceutical sales reps managed to spend an average of 12 minutes per visit with a physician; by August 2008, more than a third of physicians met with sales reps fewer than seven times a year and such interactions lasted only an average of three minutes.¹⁹

Figure 7: Criteria for assessing the value of a meeting with a pharmaceutical sales rep



Source: The New Sales Force, PharmExec.com



In the UK, a February 2009 report by the Royal College of Physicians' (RCP) working party called for a ban on all gifts from pharmaceutical companies to doctors and medical students.

Regulations restrict promotional options

The US pharmaceutical industry association, PhRMA, introduced a new marketing code, effective from January 2009, under which the sales representatives of signatory companies will no longer be allowed to hand out expensive gifts such as sport-event tickets and sponsored outings. The code also restricts representatives from handing out gifts such as pens, mugs and T-shirts.²⁰ These measures have significantly restricted the promotional options for pharmaceutical sales personnel.

In the US, similar restrictions have also been put in place by hospital groups such as the University of Pittsburgh Medical Center,²¹ Johns Hopkins Medical School²² and hospitals affiliated with the Harvard University.²³

In the UK, a February 2009 report by the Royal College of Physicians' (RCP) working party called for a ban on all gifts from pharmaceutical companies to doctors and medical students. The report also called for making all payments to medical personnel for services to the pharmaceuticals industry available on a publicly accessible database.²⁴

Declining pipelines, market slowdown and rise of generics only add to the challenges

Global growth of prescription medicine in 2008 slowed down to 4.8 percent, compared to 6.6 percent in 2007.²⁵ In the US, prescription sales grew by a mere 1.3 percent in 2008, the slowest growth in at least 47 years.²⁶ The US prescription sales growth was 8.3 percent in 2006²⁷ and 3.8 percent in 2007.²⁸

This slowdown, along with the declining pipelines and rising demand for generics, has forced pharmaceutical companies to consider reductions in sales force numbers.

How are pharmaceutical companies restructuring and reorganizing the sales force?

Strategies to counter the challenges

Pharmaceutical companies are rising to the challenges by adopting innovative sales models to gain greater access to physicians and increasing their promotional options.

*"What's happening is that pharmaceutical companies are realizing there are other ways to reach the doctor instead of banging on the door of the doctor who just doesn't want to talk to you."*²⁹

– Peter H. Nalen, President, Compass Healthcare Communications, an online drug marketer in Princeton, NJ

Restructuring and reorganizing the sales force

US pharmaceutical companies cut their sales force by 6,000 in 2008.³⁰ One prominent strategy has been to restructure the field forces to create smaller, more informed and better focused teams.

A key aspect of the reorganization has been the **reduction of sales force mirroring**, the practice of multiple representatives calling on the same targets. Under this strategy, four to five sales personnel from a single company would visit a single doctor. With the reduction in sales force mirroring, however, sales representatives currently not only spend more time with physicians but also have better and more open relationships with them.³¹ Examples of companies which have actively reduced mirroring include the following:

- In 2007, **AstraZeneca** introduced a sales model under which its pharmaceutical sales specialists (PSSs) were given fewer clients to call on. This enabled them to spend more time with each doctor and to focus on building stronger relations with the clients, improving physician access and delivering better sales impact.³²
- **Eli Lilly** reduced the number of reps calling on each doctor by reducing the size of the territory covered.³³
- **Pfizer** reduced its reps-to-doctor ratio to two.³⁴

Utilizing digital marketing

Digital marketing refers to the usage of electronic promotion (ePromotion) channels and digital tools to promote products and aid physician detailing and interaction. According to a September 2008 study by Manhattan Research, close to 45,000 US physicians already used online video to interact with sales personnel, and an additional 300,000 US physicians expressed interest in meeting sales or other pharmaceutical company representatives online.³⁵

Many companies extensively use tools such as tablet PCs to supplement visual aids used by sales personnel. For example, in 2008, AstraZeneca equipped all of its sales personnel with interactive detailing tools. These interactive detailing capabilities can potentially add two minutes to a sales personnel's interaction and can lead to up to 40 percent more product coverage in the first visit.³⁶

How are digital and electronic promotion tools aiding sales forces?

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In a research conducted
by SDI in 2008,
67% of US
physicians were positive
about ePromotion.



While interactive detailing tools increase the effectiveness of sales force personnel, the wide use of the internet by physicians is opening newer avenues for pharmaceutical companies in the form of ePromotion. ePromotion uses various channels, including e-details, online seminars, opinion leader events, web conferences and group discussions, and is increasingly attracting physicians. It provides time-constrained physicians the convenience to seek quality information when they want to. In a research conducted by SDI in 2008, 67 percent of US physicians were positive about ePromotion and 73 percent believed ePromotion to be equal or superior to face-to-face interactions with pharmaceutical sales personnel.³⁷

While ePromotion is not a new concept, it is emerging as a key marketing and sales tool. Boehringer Ingelheim used a healthcare-professional-only social network to promote its product Asasantin Retard to the UK doctors. The campaign used no print advertising or sales reps and was driven purely using ePromotion channels. The campaign was largely successful, and during the 12 months of the campaign, there were 27,000 online physician interactions and the sales of the drug increased by over 15 percent.³⁸

Utilizing contract sales organizations (CSOs)

Contract sales organizations provide flexibility by providing temporary sales personnel to fit the needs of pharmaceutical companies. In the current scenario, where pharmaceutical revenues follow patent expiration-driven cyclical patterns, pharmaceutical companies could increase the utilization of CSOs to match such cycles.³⁹

Certain companies have already started using this strategy. Merck & Co., following an announcement that it would cut 1,200 sales jobs in May 2008,⁴⁰ announced a deal in September 2008 with inVentive Health, a CSO, which would provide contract sales personnel.⁴¹ Companies are also increasingly utilizing “embedded” contract sales forces. Under this model, contract sales personnel hired and trained by CSOs work within the client company.⁴²

Utilization of medical science liaisons (MSLs)⁴³

Medical science liaisons (MSLs) are professionals with advanced degrees in medicine and pharmaceutical related sciences. Unlike pharmaceutical reps, MSLs are utilized by the pharmaceuticals industry primarily to coordinate the flow of clinical information and maintain key opinion leader relationships. As physicians demand more informed and detailed information regarding products, reps are finding it harder to maintain strong relationships with physicians and key opinion leaders. As MSLs tend to be more knowledgeable and can engage in deeper scientific discussions with physicians than sales reps, pharmaceutical companies could do well to use MSLs more in order to maintain, and gain more, access to physicians, especially when dealing with complex specialty drugs.

"MSLs who are actually interacting with physicians via phone calls, chats or online are spending a greater proportion of their time talking to doctors than the sales rep. Even though they're more expensive, you get more return on that money;"

– Jan Malek, Director of IBSG and co-leader of life sciences for Cisco

Pharmaceutical companies have started to use more MSLs. According to The Medical Affairs Company, a contract medical organization, in 2008 it observed a trend toward an increased growth in specialty MSLs.

Conclusion

The current challenges are a clear indication that traditional sales models will radically change. Specialty drugs and focus on the therapeutic effectiveness of drugs are going to make drug promotion more challenging for the pharmaceutical sales forces.

Pharmaceutical companies will have to utilize a mix of strategies such as ePromotion, MSLs and contract sales organizations to bolster the efficiency and effectiveness of the sales force teams and the individual sales representatives.

FURTHER INFORMATION

Visit kpmg.com for the following related publications

- *The Tablet - KPMG's Views on regulating sales and promotional compliance*
- *The Tablet - KPMG's Views on Risk Mitigation in the Pharmaceutical Industry*

How KPMG firms can help

Preferred Practice

Our firms' approach to sales and promotional compliance is designed to deliver six key activities which can respond to increasing regulatory requirements:

- Policy and business rules definition
- Designing controls, reporting and systems strategy to capture and analyse and report data

- Workforce communications to improve awareness of healthcare professional responsibilities
- Training strategies and materials to improve levels of compliance
- Development of metric scorecards to track and measure compliance performance
- Leadership education and coaching

This approach seeks to provide assurance to our firms' clients so that they can meet and 'future proof' data reporting requirements from increasing regulation in a cost efficient manner that also focuses on the 'human aspects' of ensuring compliance.

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3

IT outsourcing in pharmaceuticals

Pharmaceutical companies are exploring alternative methods of cost savings and seeking greater efficiencies. One such initiative is IT outsourcing. IT now forms an essential part of various processes, such as manufacturing, supply chain management, and R&D, and often drives process efficiencies and business innovation.



IT outsourcing is expected to account for **23%** of the overall IT services spend by 2010.

How can your company benefit from IT outsourcing?



The need for IT outsourcing

IT outsourcing is expected to account for 23 percent of the overall IT services spend by 2010. Forty-eight percent of pharmaceutical companies were already outsourcing certain aspects of manufacturing or supply chain IT in 2008.⁴⁴

Cost savings is one of the primary factors driving IT outsourcing in the pharmaceutical industry. Outsourcing reduces the costs of resource management, space and staff. This in turn allows companies to channel greater investments into their core competencies. IT outsourcing also allows companies to shift their attention away from ancillary and non-core functions such as administration and maintenance of IT.

Compared to in-house IT teams, which tend to be smaller and have limited expertise, IT outsourcing vendors can provide **greater expertise** due to better experience and a larger talent pool.

Key IT functions outsourced

The top three project types handled by the leading IT outsourcing vendors are application outsourcing, infrastructure outsourcing and systems integration. In fact, systems integration is the biggest contributor to IT services spend, accounting for more than 40 percent.⁴⁵

Table 3: Top IT outsourcing vendors by lifescience project type as a percentage of all projects⁴⁶

Company	Application outsourcing	Infrastructure outsourcing	Data storage outsourcing	Systems integration	BPO	Strategic consulting	Other
Capgemini	2	40	–	39	8	11	–
Cognizant	40	5	5	25	15	5	5
HCL Technologies	50	18	3	–	–	–	29
IBM	NA	NA	NA	NA	NA	NA	NA
Infosys	65	24	–	6	–	5	–

Company	Application outsourcing	Infrastructure outsourcing	Data storage outsourcing	Systems integration	BPO	Strategic consulting	Other
Intelligroup	75	5	–	10	–	10	–
Persistent	95	–	–	2	2	1	–
Satyam	50	6	–	27	12	5	–
TCS	70	10	–	–	15	5	–
Wipro	75	5	–	13	5	2	–

Big Pharma takes the lead in IT outsourcing

In recent years, many top pharmaceutical companies have entered into agreements with IT vendors to outsource IT functions and infrastructure maintenance. Table 4 shows some of the recent and significant IT outsourcing deals.

Table 4: Recent IT outsourcing agreements

Year	Company	Vendor	Details
September 2008	Bristol-Myers Squibb ⁴⁷	Accenture	A ten-year, US\$550 million agreement to provide application development and maintenance, along with other services such as finance and accounting support
April 2008	Nycomed ⁴⁸	British Telecom and HP	A five-year contract to manage Nycomed's IT infrastructure needs across its international networks
January 2008	Allergan ⁴⁹	ACS	A US\$130 million contract to outsource IT functions
December 2007	Bristol-Myers Squibb ⁵⁰	EDS	A seven-year, US\$715 million agreement to provide IT infrastructure services to Bristol-Myers Squibb
December 2007	Merck ⁵¹	Cognizant	A multiyear, multimillion dollar agreement for applications outsourcing, IT infrastructure management and business process outsourcing services
July 2007	AstraZeneca ⁵²	IBM	Seven-year, US\$1.4 billion agreement with IBM to establish a single global technical infrastructure for AstraZeneca across 60 countries

The industry is viewing IT outsourcing not just as a mere cost-saving strategy, but also as one that can provide efficiencies in business processes and drive innovation within organizations. The 2007 AstraZeneca-IBM agreement exemplifies this emerging shift.

New outsourcing model: The AstraZeneca and IBM case⁵³

In July 2007, AstraZeneca signed a seven-year, US\$1.4 billion IT outsourcing agreement with IBM. The agreement goes beyond just being an extension of the 2001 deal between the two companies. Beyond simply increasing the geographic coverage from 45 to 61 countries and at a lower cost (from US\$1.7 billion to US\$1.4 billion), the deal also represents a strategic shift from delivery of IT services to the delivery of business outcomes.

The deal marks AstraZeneca's shift from pursuing IT outsourcing to achieve cost savings to pursuing greater quality. Under the new agreement IBM will:

- be able to better utilize its expertise and global presence to deliver IT solutions

Can IT outsourcing deliver business outcomes?





According to a survey of 178 lifescience industry leaders, approximately **22.5%** of lifescience companies plan to increase IT outsourcing in 2009.

- be eligible for additional bonuses if it exceeds AstraZeneca’s business outcome requirements
- have a new and direct role in both defining and implementing (control of implementation decisions) AstraZeneca’s global IT infrastructure design
- have new responsibilities to deliver innovative customer services, which if not achieved could pose a potential risk for IBM

Through these measures, the agreement facilitates incentivization, better adaptation of emerging IT best practices and the ability to accommodate change and growth in AstraZeneca.

Outlook

2009 will see an increase in IT outsourcing adoption. This is expected to be followed by a steady growth of approximately 8 percent annually for the next 2 – 3 years. According to a survey of 178 lifescience industry leaders, approximately 22.5 percent of lifescience companies plan to increase IT outsourcing in 2009.⁵⁴

The current challenges and globalization of businesses have reinforced IT outsourcing as a key strategy for pharmaceutical companies looking to achieve greater cost savings and efficiencies. While challenges such as privacy issues, regulatory issues, intellectual property issues, cultural differences and security still pose significant hurdles, the pharmaceutical industry is heading towards increased adoption of IT outsourcing as companies shift their focus from achieving cost savings to emphasizing quality, improvement and innovation of business processes.

FURTHER INFORMATION

Visit kpmg.com for the following related publications

- *Rethinking the business model*
- *Strategic evolution: A global survey on sourcing today*
- *A New Dawn - China’s Emerging Role in Global Outsourcing*

How KPMG firms can help Efficiency and cost optimization

Working alongside clients, our firms’ professionals help to streamline processes, to enhance controls and to contain costs and business risks. We look at systems, supply chains, capital structures, intellectual property and contracts with third parties to see how they can best be utilized. We identify areas of weakness that might jeopardize achievement against objectives, as well as, advising on the development and execution of management systems to create sustainable business performance.

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