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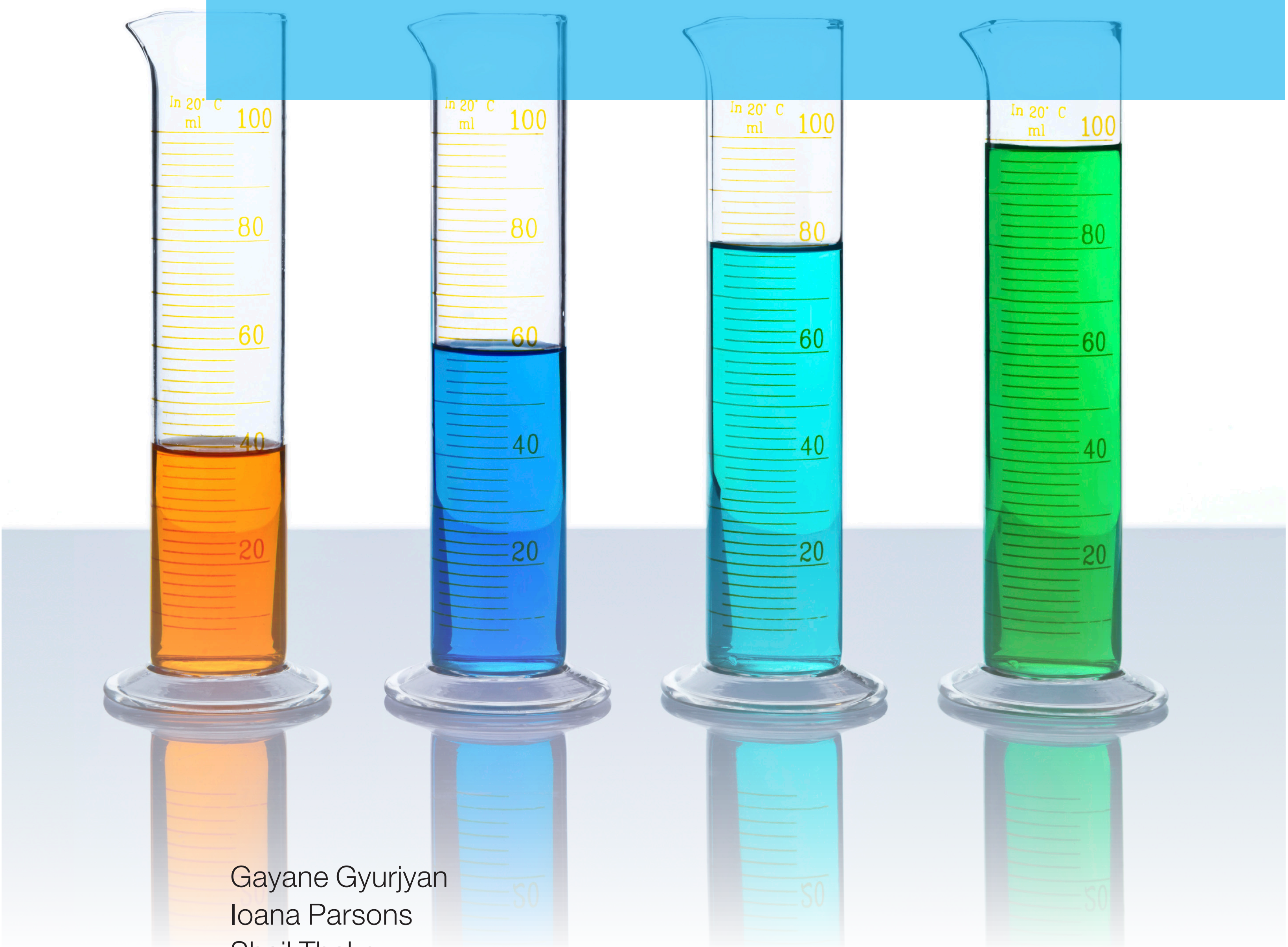
A health check for Pharma: Overcoming change fatigue in the pharmaceutical industry



Gayane Gyurjyan
Ioana Parsons
Shail Thaker

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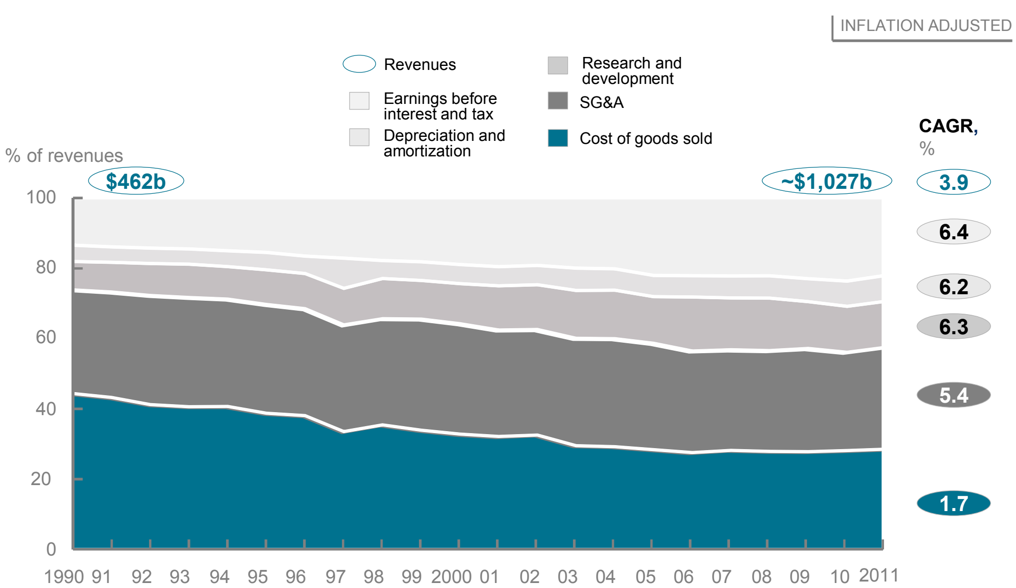
After almost a decade of cost cutting, restructuring, transformations, and turnarounds, the pharmaceutical industry is understandably showing signs of change fatigue. Our analysis of changes in the organizational health of our sample of pharma companies indicates that many feel they are suffering a loss of external focus, a lack of clear direction and an overemphasis on near-term delivery. There are vast differences between companies: some are managing to thrive despite the adverse environment, but many are struggling. Those that are delivering better financial performance are maintaining a stronger focus on innovation and the customer. Understanding what steps they have taken to do this could offer lessons for companies that are mid-way through their multi-year journeys and are now seeing change fatigue creep in.

The case for change

Change has been at the forefront of pharmaceutical executives' minds for a long time, and the pressures have been rising steadily. Since 2007, even before the economic crisis began, companies have been announcing cost-reduction measures, largely driven by the patent cliff. And following the financial crisis, they have seen a massive acceleration of the challenges in the external environment . Some have implemented extensive layoffs and site closures. Many are undertaking transformations to reinvent their commercial model, restructure their R&D, streamline their manufacturing footprint, or all three. Among those doing so, more than half say their main goal is to reduce costs or improve productivity.

Yet despite these efforts, the industry in aggregate has seen little improvement. For instance, over the past 20 years SG&A and R&D expenses have grown 40 to 60 per cent faster than revenues (Exhibit 1). Progress has been made in the relative reduction of cost of goods sold, which have grown more slowly than revenues. However, most companies recognize that there is still a considerable way to go against the backdrop of expected flat top-line growth for the industry.[2]

Exhibit 1: Cost cutting has had limited success



1 An analysis of a sample of companies shows the impact of market access initiatives on sales went from 1-2% per year in 2009 to more than 6% in 2013 (depending on the portfolio).

2 Our analysis of data from Evaluate and the annual reports of the top 15 pharma companies by revenue in 2012 suggests that revenues will grow by just 0.7 per cent CAGR between 2012-2017, a sharp drop from the 3.7 per cent growth seen in 2007–2012.

Why performance is not enough

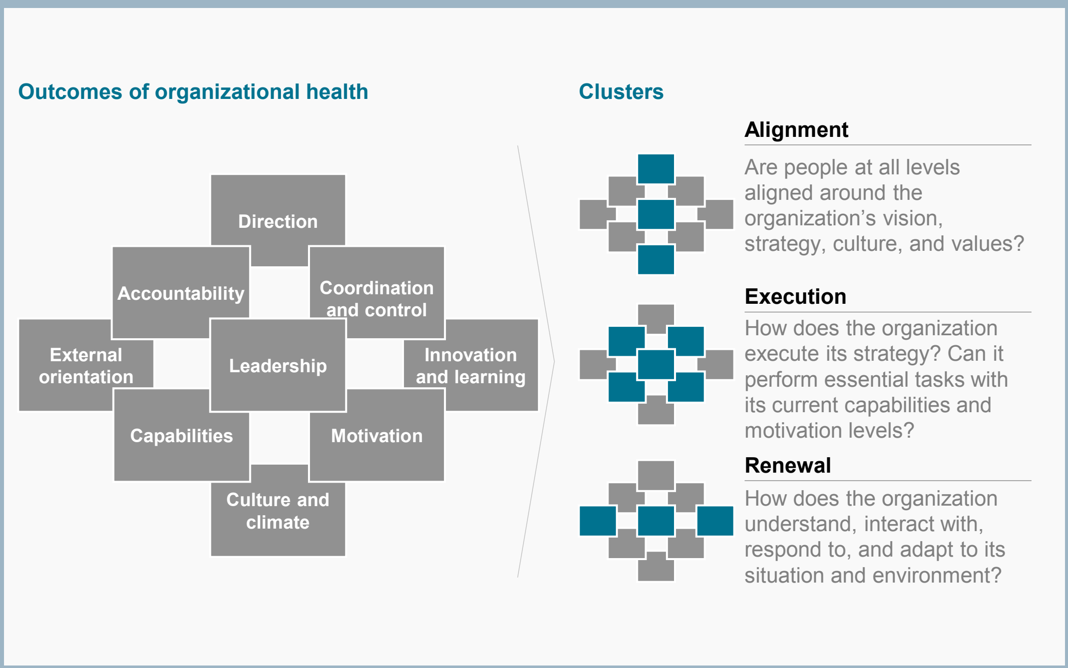
To achieve and sustain strong performance over time, leaders must manage their company's health as well as its performance. The difficulty they face is that organizational health factors such as culture and motivation can be harder to measure and address, leading some executives to dismiss them as "soft stuff".

To tackle this problem, McKinsey & Company developed the Organizational Health Index (OHI), which provides a precise vocabulary and reliable measures to make health as tangible and manageable as finance or operations. We define health as an organization's ability to align, execute, and renew itself more quickly than competitors can, enabling it to sustain exceptional performance over time.

The OHI is based on a survey tool that measures an organization's health in terms of 37 management practices that contribute to nine outcomes* (Exhibit A). Our database covers almost 1.5 million data points from more than 800 organizations in 22 industries, including pharmaceuticals.

An analysis of the OHI data across industries reveals that there is a strong positive correlation between organizational health and business performance. For example, companies in the top quartile for organizational health are likely to have total returns to shareholders that are three times those of peers in the lowest quartile.†

Exhibit A: Measuring organizational health



* The nine outcomes in the OHI are direction, leadership, culture and climate, accountability, coordination and control, capabilities, motivation, innovation, and external orientation. Each is made up of three to five management practices, or sets of behaviour exhibited by an organization. For instance, the "capabilities" outcome is made up of talent acquisition, talent development, process-based capabilities, and outsourced expertise.

† For more information on the OHI and the research underpinning it, see chapter 2 of *Beyond Performance*, Scott Keller and Colin Price, Wiley, 2011.

Budgetary pressures aside, pharma companies are adjusting to a multitude of other challenges: an increasingly complex stakeholder environment, greater difficulties in securing market access, closer scrutiny and more stringent regulatory requirements, and changing behaviour and communication preferences among both healthcare professionals and patients. Against this background, it is hardly surprising that the industry appears to be experiencing change fatigue. The quotes below are indicative of comments we have frequently heard from the frontline over the past few years:

> "We have been through three reorganizations in the last two years. We no longer fully understand who does what, and honestly, we don't really try; it might change again soon." —*Head of sales in a country organization*

> "We are supposed to do more work always with fewer people. With all these pressures and changes, we are not really thinking about our customers and their needs, but about our survival." —*Country head of primary care*

> "I moved my family across three countries for this company. Now I have no idea where it's going or even if it will be here in two years' time." —*Regional CFO*

Even though pharma companies are experiencing pressures, the disaffection revealed in comments like these is making it much harder for them to drive continuous change. Leaders need to find a way to reinvigorate their organizations to enable them to complete their transformations, restore their health, and renew themselves. More than ever, companies need to be resilient and adaptable, and able to rethink every aspect of the way they do business – from how they engage with physicians to how they use big data. Before they can do that, though, they need to understand the nature of change fatigue and take the necessary steps to plan for it and to overcome it.

A health check for pharma

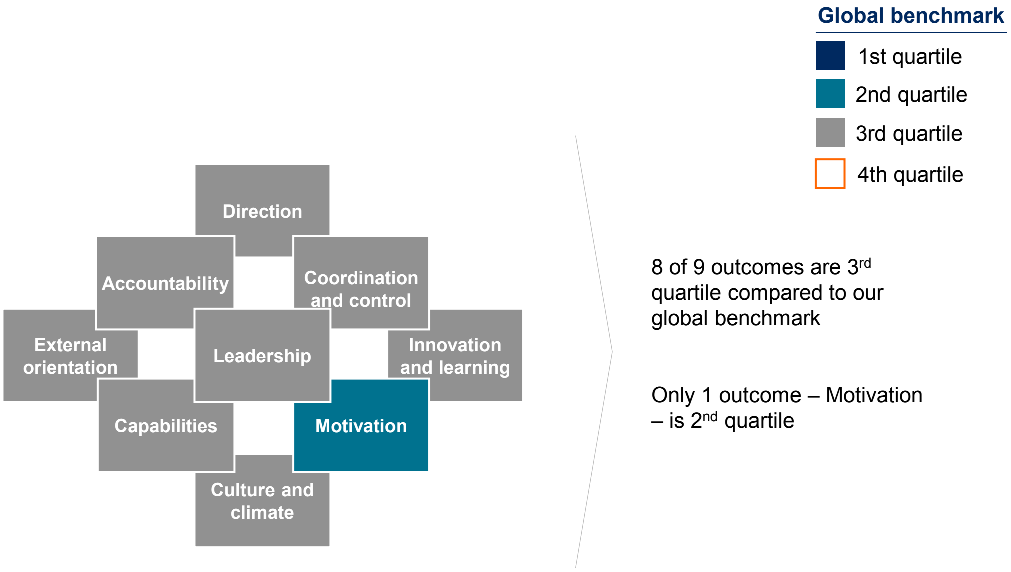
To better understand the health challenges pharmaceutical companies are facing, we mined our proprietary data sets, analysing the responses of pharma companies to the questions in our OHI survey database and in our Transformational Change surveys.

The OHI data came from surveys conducted between 2006 and 2013, with almost 20,000 respondents. Our sample comprised a mix of large and medium-sized companies operating in specialty or primary care, and covering prescription drugs, generics, and consumer pharmaceuticals. We examined the emerging trends in health scores over time, comparing two independent samples of pharma companies (surveyed between 2006-2011 and 2011-2013, respectively), and conducted interviews with industry experts to shape and test hypotheses.

Overall, we found that the pattern identified in the cross-industry database holds true for our sample pharma companies as well: healthier companies tend to have stronger financial performance. A comparison of companies in the top and bottom quartiles for organizational health indicates that healthier pharma companies have 2.3 times the rate of TRS (total returns to shareholders) growth compared to unhealthy companies.

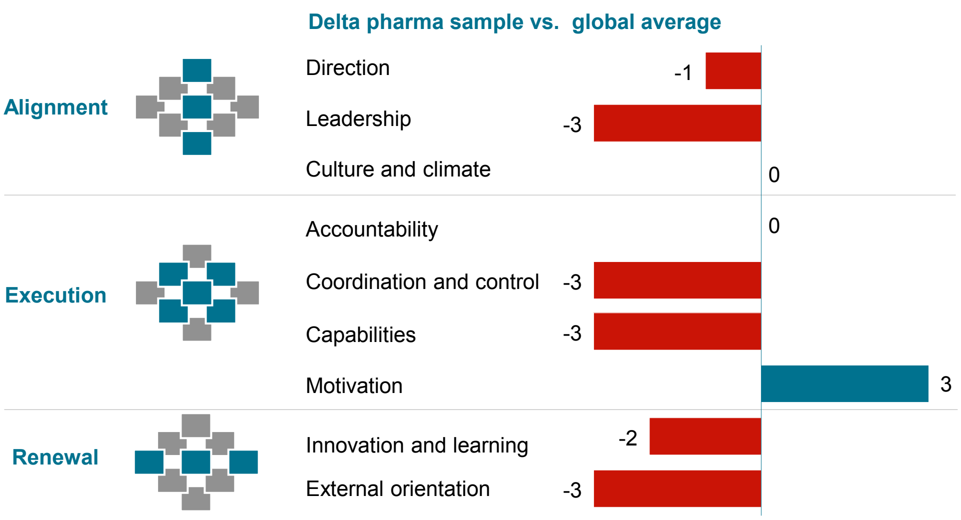
However, when we looked at the health of the pharma companies in our sample as a group and compared them with the global norm, we found that they do not start from a position of strength (Exhibit 2).

Exhibit 2: On average, our sample of pharma companies do not start from a position of strength in terms of organisational health



The 'average' pharma company in our sample does not score in the top quartile for any of the nine health outcomes in the OHI; indeed, it scores above average for only one outcome (Exhibit 3).

Exhibit 3: The average scores for our sample are below par for several outcomes



N.B.: Deltas not statistically significant due to sample size

Our analysis also reveals that there are significant differences in health between the pharma companies in our sample. Size is one factor in these differences: compared to small and medium-sized companies, big players underperform on all health outcomes except motivation. In particular, they report significantly-lower scores – by more than 10 percentage points[3] – on practices such as customer focus, capturing external ideas and employee involvement. Even so, some pharma companies manage to break the pattern and attain top-quartile health in spite of size or environmental challenges.

What is ailing pharma? The anatomy of change fatigue

Having established a general picture of health, we took a closer look at the scores of our two independent samples of companies surveyed from 2006–2011 and 2011–2013. Although there was little difference in the industry's overall 'average' health score from one period to the next, in some of the dimensions there was a marked shift (Exhibit 4).

Exhibit 4: Leadership and direction scores have declined from the pre 2011 sample to the post 2011 sample

1 Statistical significance testing involved independent sample T-tests

3 Statistically significant difference at p<0.05.

By comparing the two periods, we identified five symptoms of change fatigue:

1 A decline in sense of direction

The management practices that combine to create a sense of direction – namely shared vision, strategic clarity, and employee involvement – have fallen by between 5 and 10 percentage points each since 2011, from an already low base. In fact, additional research[4] shows that the pharma industry sample performs well below the cross-industry average for direction. Fewer than one in three pharma employees surveyed believe their CEO provides thought leadership and direction, and fewer than one in nine believe their top team does so. These numbers are substantially below those for the cross-industry average, with a delta of 7 and 10 percentage points respectively. It would appear that the pharma industry seeks leaders who are able to set and sustain a clear and compelling vision against a backdrop of frequent reorganizations and leadership changes. This may reflect the inevitable upheaval of an industry which enjoyed stable growth for more than 20 years and is now grappling with choices on multiple fronts (e.g., portfolio and pipeline challenges, external market changes, radical shifts in patterns of economic growth and technology, etc.).

2 A radical shift in leadership styles

Leadership styles also appear to have undergone a dramatic change in the past few years. The trend shows a hike in authoritative leadership and a marked decline in consultative, supportive, and inspirational leadership[5]. The emphasis placed on authoritative leadership differs markedly across the companies in our sample: those in the bottom quartile rank it first among the 37 practices in the OHI, whereas those in the top quartile name it as one of the least-frequently-used practices.

As external volatility increases and the pace of activity steps up, there is pressure on leaders to secure near-term delivery. This could explain the perceived change in leadership style. The decline in consultative leadership in particular (used by leaders who involve and empower employees through communication, consultation and delegation) appears to have a direct repercussion on the sense of direction as noted above.

3 A more inward focus

Although most pharma companies are trying to put customers and patients at the heart of what they do, often by making customer centricity an explicit goal for their transformations, employee perception of external orientation for our sample has declined since 2011. All elements of external orientation show a downward trend. Customer focus, competitor insights and government and community relations all fell by between 5 and 10 percentage points. Partnerships remained almost at similar levels, potentially linked to increased deal-making activities.

Innovation and learning elements are also suffering in the current climate, with a double-digit percentage point drop in the score for the ability to capture ideas and best practices from outside. Top-down innovation, bottom-up innovation and knowledge sharing also are also trending downward.

There are a few potential drivers for this. Firstly, the organisations could have been distracted by the on-going restructuring and continuous change. Further, the external environment and the customer needs could be changing quicker than the pace at which the companies themselves can adapt.

4 A burdensome approach to managing key processes

As compliance, quality, and good manufacturing practices come under increased scrutiny, the emphasis on the processes used to manage these functions – without meaningful simplification elsewhere – appears to be creating new burdens for organizations.

4 McKinsey Transformational Change Survey 2012.

5 Trends in authoritative leadership (increase) and consultative leadership (decline) are statistically significant different at $p<0.05$

This is apparent in the ranking of the Professional standards practice in OHI, which this is ranked much higher by unhealthy companies than by top-quartile healthy players (17th vs. 30th out of 37 practices). As one sales rep told us, "Ways of doing business have changed – we now need to get approvals from many departments for everything. I understand it's important, but it costs us a lot of time and energy, and could be managed better."

Conversely, companies in the top 'healthy' quartile of our sample overemphasize practices such as risk management, personal ownership and consequence management (all top-10 practices). There is a striking difference between top- and bottom-quartile pharma companies in the extent to which they focus on risk management, which is ranked much lower by bottom-quartile than top-quartile players (32nd compared with 3rd out of a total of 37 management practices).

5 A lack of investment in managing change
Pharma companies are seen as failing to invest in the skills, resources, measurement, and top team focus they need to manage the process of change. Although this is a widespread perception across industries[6] – 73 per cent of all survey respondents feel their organization does not have enough people with change management skills – it is especially so in pharma, with a score of 83 per cent. Moreover, only 7 per cent of pharma respondents feel their senior executives use order, effective processes, and effective team interactions to move toward their overall goals, compared with 15 per cent across industries.

Three actions to shake off change fatigue

Change fatigue is highly contextual and the particular points of vulnerability may vary significantly by company – hence there is no substitute for detailed planning and understanding specific risks for every individual company. That said, we do see three areas of opportunity as companies ready themselves for the multi-year journey:

1 Ensure an appropriately-resourced and disciplined approach to transformation
Any company undertaking major organizational change should follow a rigorous approach to secure the optimum impact. Our beliefs on the key steps are summarised in the sidebar "Best practice in transformation".

In our experience, few pharma companies treat change management as a core business initiative or staff the transformation efforts with the best talent they have. One company undertook a systematic review of its internal projects and found that only 30% of them delivered on time and fully. Left to chance, this is not surprising since it mirrors success rates of change efforts across industries. Pharma companies ignore at their own peril the fact that systematic management of change is an organisational capability in itself, on a par with business development or launch readiness. It also requires specific mindsets, such as accepting the continuous nature of change and the need constantly to learn, adapt and manage ambiguity. Exceptions do exist, however: at one company, all high-potential staff are expected to rotate through an internal six sigma group so that they can develop the 'muscle' to drive change at scale, be it a frontline transformation or supply chain excellence.

Additionally, we observed two areas where companies often do not put sufficient focus when going through the transformation:

- Tell a consistent and congruent change story[7]. Our cross-industry research shows that a transformation with a clearly articulated and widely shared change story is 3.7 times more likely to be successful than one

6 McKinsey Transformational Change Survey 2012.

7 The change story is a narrative that leaders share with their teams in order to involve them and to create clarity on the case for change, the vision and how this will be achieved, what they can expect from the leader and is expected of them. It is critical to any transformation.

Best practices in transformation

From our experience with hundreds of transformations in pharma and other industries, we have identified what leading companies do to bring about sustainable change with the maximum long-term impact. They typically adopt a systematic approach consisting of five steps:

Aspiration. They articulate a clear vision of what their organization wants to become and translate it into tangible targets for measuring success.

Diagnostic. They assess their organization's current and target state, including its competitive position, the shape of key value pools, its resource allocation, and its readiness for change.

Specification. They describe the impact they expect the transformation to make and frame granular objectives for each part of the organization to help achieve it.

Design. They define the future go-to-market approach and operating model, starting from a clean sheet.

Value delivery. They develop a transformation plan for rolling out and sustaining the necessary changes and managing the process of change itself.

without. Clarity over what an organization is striving to achieve through change is even more important in an environment where the sense of direction and shared vision are declining. An effective change story is evergreen, maintaining a central theme or a few strategic priorities that run like a thread through an organization's communications for years, while leaders make adjustments to other parts of the story as business realities and priorities shift over time. During times of stress, employees will welcome the clarity of what is constant and what is evolving, as well as frequent repetition. The best change stories both provide a 'North Star' and foster a mindset of continuous change, the belief that companies can only be successful in the long term if they are able constantly to transform themselves. The most impactful repetitions are story cascades, where managers at all levels, following on from the CEO and top team, articulate the same messages in a way that is tailored to their own context.

- Build in regular proof points that are defined early and reinforced in the change story as the organization's transformation progresses. Regular proof-points are critical both in keeping up momentum among supporters and in winning over the sceptics. One pharma CEO identified three therapy areas as strategic priorities. The proof points he gave his organization ranged from targeted acquisitions in these therapy areas (and no other areas) to headcount resource investments, to 'air time' during business reviews. The latter was particularly impactful as his behavior sets the tone: not only did he completely ignore one of the top-selling drugs in another TA, but he even stopped a marketing manager who tried to give him an update.

2 Strive for meaningful simplification

What we often see is reduction in headcount without thought to changing underlying ways of working – and in particular with little clarity and communication of what the organization will *not* do going forward. When they do plan simplification, many global companies seem to have a bias to over-focus on structures and neglect processes[8]. This is especially risky in a world where the burden of necessary processes (e.g., compliance, quality, regulatory) is driving incremental workload for pharmaceutical companies. Managing necessary processes can put new strains on an organization if there is no simplification elsewhere.

8 Our recent research on Global organisations illustrates a blind spot on processes, as only a quarter of respondents agree that 'Our priority global processes are highly efficient and effective' and 'This organization reduces the number of its standardized global processes as has expands globally'.

These simplifications are not easy to implement since they often require reassessing some of the core processes that define a company (e.g., business planning, strategic planning, portfolio assessment, etc.). They also require a methodical capability to pilot, experiment and then scale up – not a traditional area of strength for pharmacos. However, the prize for doing this can be large. For example, one company appointed a cross-functional team to assess, simplify and automate its process of approving reps' activities and expenses. Their goal was to release unproductive time. By cutting duplicative steps and review loops they freed up the equivalent of more than 10 per cent of the sales force's time; this capacity was redeployed to customer-facing activities.

3 Over-index on external focus

Most pharmacos name customer- or patient-centricity as one of the key objectives of their transformation, so in many ways the decline in external orientation is the most counter-intuitive finding of our analysis. Many would argue the pharma industry has yet to 'crack the code' of customer-centricity (to the level of key account management excellence from FMCG or digital insight and use of data from online banking). Constant upheavals make it even more difficult. However, beyond the obvious distraction risk of multiple rounds of organization changes, we see a series of second-order pitfalls against which to guard:

- Suboptimal communication: if the rationale for implementing frontline model changes – e.g., to deliver more tailored service to different customer segments – is poorly communicated, this can raise suspicion around the true motives. As one interviewee put it:

  > "The original 'customer-back' rationale for why we were changing got lost in the rounds of targets and in the end we forgot we were supposed to be reinvesting to strengthen capabilities as well" *Business Unit Director*

- Slower speed of reaction: in times of change the speed of response in many processes, even the critical customer facing ones, can significantly slow down. Maintaining focus takes real leadership and contingency planning:

  > "I couldn't get pricing approved for a big tender as it was unclear who in the European organization could sign-off" *Country head of primary care*

We see companies using a range of 'forcing mechanisms' to compensate. The European organisation of a global company chose to implement 'voice-of-the-customer' linked incentives in the middle of their 'patent cliff', while also going through an operating model transformation. In spite of the uncertainty, this was perceived as a strong signal that their new provider-focused model was there to stay. Reps took only a few months before coining a new mantra: 'Listening to my customer pays the bills'. Another company changed the organisational structure: reducing the number of layers from 8 to 6 led to a large reduction in the time its marketers spent internally (from ~80 per cent to less than 50 per cent). Other formal mechanisms such as mandating a certain percentage of time spent with customers, driving participation in external networks or time spent with external advisors can also send strong signals that the organisation is serious about external focus.

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If you recognize any of the symptoms described above, your organization could be suffering from change fatigue. To overcome it, we recommend you start by gaining insight into your specific situation, learn lessons from the winners in organizational health, and pay particular attention to the three actions that successful companies adopt to keep their organizations and transformations on track. Otherwise, your transformation could burn out before it takes off.

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