

The Pharmaceutical CFO's Expanding Agenda



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The challenges and expectations facing pharmaceutical chief financial officers and their finance organizations are greater today than ever before. They operate in one of the most highly regulated industries in the world and under intense scrutiny. Fundamentals of the business model are transforming rapidly, and the finance function is instrumental in navigating the evolving landscape and defining new strategies. In doing so, finance needs to work seamlessly both across internal silos, to understand the issues facing every function — from human resources to sales and marketing — and outside the organization to address the demands and expectations of the capital markets, investors, and regulators.

To provide insight on this issue, the Economist Intelligence Unit, on behalf of Ernst & Young, surveyed 95 senior-level executives at pharmaceutical companies during September and October 2007. Half the respondents represented companies with more than US\$10 billion in annual revenues; the remainder generated annual sales of at least US\$1 billion. Nearly two-thirds of the respondents were based in either North America or Western Europe. This survey was part of a broader cross-industry survey involving 250 C-suite and board-level executives, providing a benchmark for comparing responses by pharmaceutical executives.

Analysis of the responses identified several significant findings:

- CFOs need to spend more time serving as business partners to the CEO and the board of directors in shaping strategy rather than on defensive monitoring and reporting exercises.
- The CFO is perceived as the leader of cost reduction and streamlining efforts, which pharmaceutical companies have widely adopted across functions and geographies.
- More pharmaceutical respondents are considering outsourcing and shared service models for certain internal functions than those in other industries, with regional shared services more likely than outsourcing for future cost cutting around basic finance functions and medium-to-advanced finance activities.
- Pharmaceutical CFOs are perceived as having a good understanding of the wider business, but there is room for improvement in their ability to collaborate and share certain information with other departments.

The CFO's Changing Role

The role of the CFO today combines tactical and strategic elements to an unprecedented extent. Among our respondents, there was nearly unanimous agreement (96%) that the responsibilities of the CFO have expanded and evolved over the past decade, paced, in order of importance, by:

- Increasing regulatory and compliance requirements
- Corporate governance obligations
- Risk management

Add the growing demands by investors for heightened disclosure of financial data, and it is perhaps not surprising that a majority of the pharmaceutical executives surveyed believe that today's CFO spends the bulk of his or her time wrapped up in defensive monitoring and reporting exercises.

Our survey reveals that a broad coalition of pharmaceutical executives — respondents ranged from managers and department heads to CEOs — think this is a misallocation of the CFO's time. Nearly three-quarters stated that they would like to see their finance chief take a greater hand in serving as a business partner to the CEO and the board of directors in shaping their company's strategic plans.

CFOs in the pharmaceutical space are beginning to take on a more strategic role as they pare costs and orchestrate efficiency. According to the survey, pharmaceutical CFOs have a stronger focus on expense controls than their counterparts in other industries. A greater percentage of pharmaceutical respondents cited enterprise cost reduction as a top priority (28%) compared to the non-pharmaceutical sectors (20%).

Our survey showed a definite divide between the activities that currently occupy the CFOs' time each day and where, optimally, they should be dedicating their attention. We asked the respondents to choose among four typical roles:

- **The Scorekeeper:** Monitors and reports the company's results; monitors and works with external regulators; monitors and reports on tax and transfer pricing
- **The Commentator:** Provides reports to the board and audit committee; provides information for investors; reports on reasons for changes to forecasts; reports on treasury results

- **The Custodian:** Develops and improves financial controls systems; is responsible for internal control systems; manages financial and business risks
- **The Business Partner:** Participates in strategy development; leads merger and acquisition (M&A) activity; provides leading indicators for business performance

While most of those surveyed estimated that CFOs spent the bulk of their time addressing the first three roles, a large portion concluded that time spent as the company's scorekeeper should be reduced. On the other hand, a significant number believed the roles of "custodian" and "business partner" should be enhanced, with the latter claiming the top spot (74%) among activities that should predominate in the CFO's agenda (see Exhibit 2).

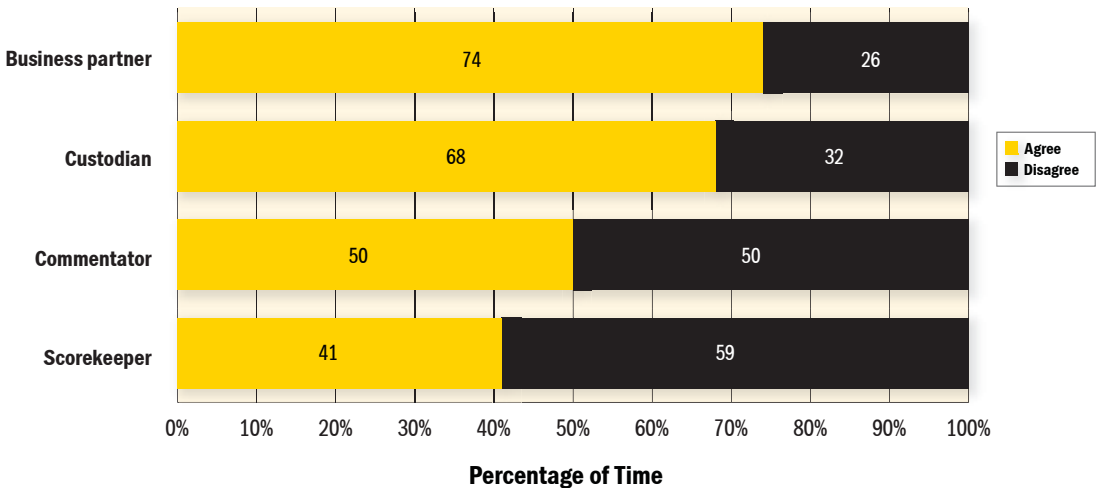
Three-quarters say CFO's role should be as a business partner.

When asked on what specific functions the CFO should be focusing the most, pharmaceutical executives' responses mirrored those we received from other industries. Top vote-getters were acting as a strategic partner to the board (65%), annual budgeting and outlook forecasting (65%), risk management (55%), business management reporting (49%), and regulatory and external reporting (48%).

Focus on Costs

A focus on costs is well established in the pharmaceuticals industry, and the survey indicates that it has been embraced widely across functions and geographies. There was near-universal agreement that cost reduction has become essential, with 92% citing it as a key issue in their business, compared with 85% of respondents in other industries (see Exhibit 3). A greater portion of pharmaceutical respondents reported that expense reductions had been implemented throughout their organization — 49% versus 43% for nonpharmaceutical.

Exhibit 2: To which activity should your CFO be allocating the most and least time?



Cost reduction is key issue for 92%

Exhibit 3: Indicate whether you agree with the following statements.

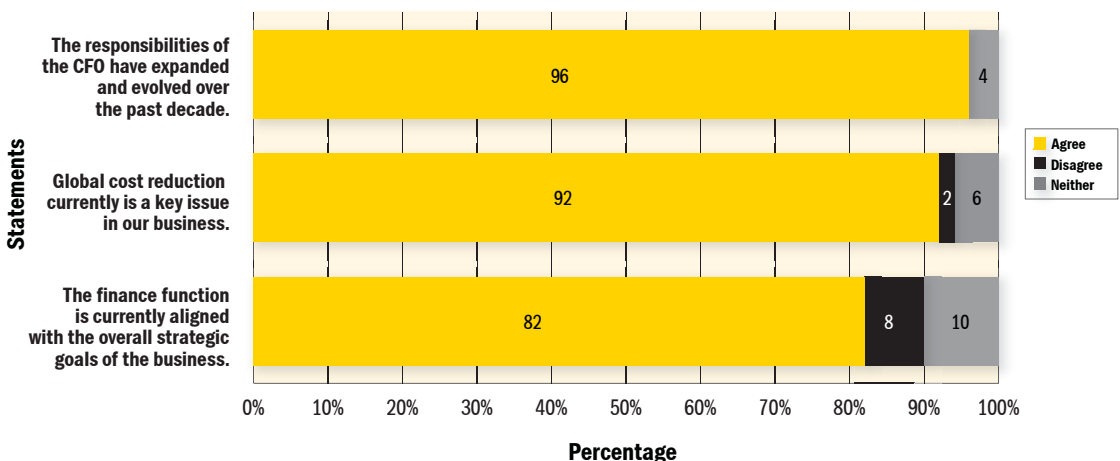
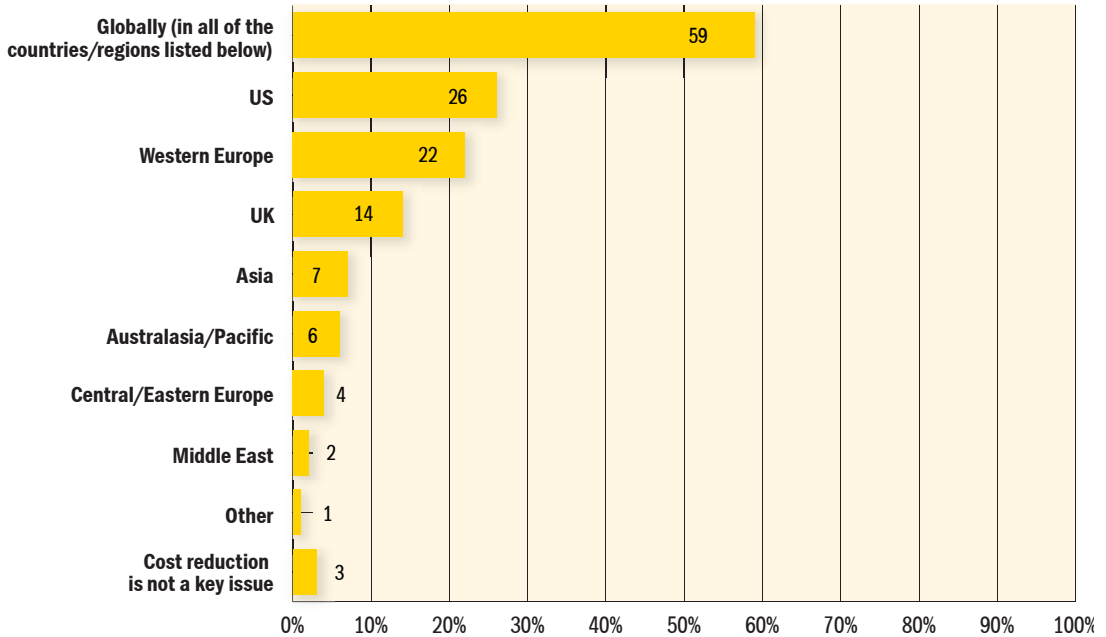


Exhibit 4: **How broadly has cost reduction been implemented in the following regions in your organization? (select all that apply)**

Fifty-nine percent have cut costs across the globe.



Executives in the industry see the CFO, and not the CEO, as the business leader within the organization leading the charge to operate more efficiently. Fifty-six percent said it was the CFO who would be responsible for steering any cost-reduction initiatives, the same number as in the non-pharmaceutical survey. But only two in five (40%) attributed responsibility to the CEO, compared with half (50%) of the respondents in the broader survey, establishing a clearer front-runner for managing enterprisewide expenses.

Pharmaceutical respondents differed from the broader nonpharmaceutical group in several key areas. They reported deeper cuts in their sales and distribution networks (29% versus 19%), but revealed less attention to information technology (23% versus 30%), human resources (11% versus 19%) and tax (7% versus 16%).

Given the sector's increasing international reach, it was predictable that 59% of those surveyed experienced efficiency drives established across the globe, compared with just 42% among other sectors. Regions experiencing the most pervasive cost reductions were the US (26%), Western Europe (22%), and the UK (14%). (See Exhibit 4.)

Respondents across all industries expressed common ground in the factors that are driving cost reductions within their own organizations. Competitive pressures and profitability were seen as the leading contributors (58% each), while increasing demand from investors (33%) and globalization (also 33%) were also cited as meaningful causes.

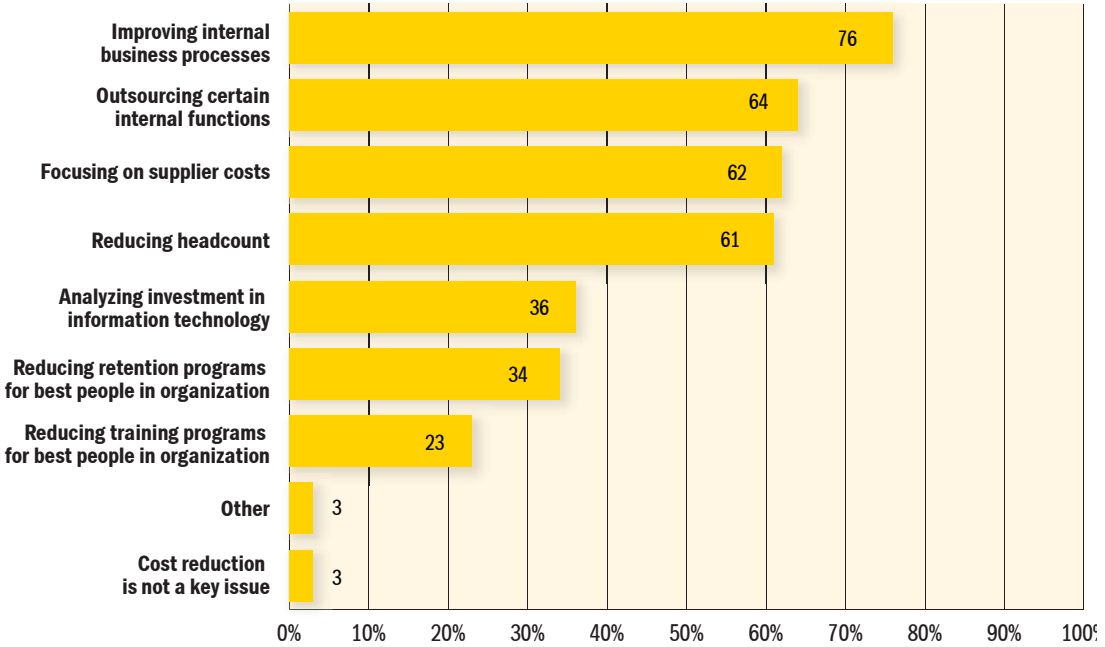
Outsourcing and Shared Services

When prompted on areas currently under consideration for cost reduction, more than three-quarters (76%) of the pharmaceutical respondents pointed to improving internal business processes, in line with other industries that were surveyed.

Yet a wide disparity surfaced when it came to some key initiatives on the table. A significantly greater portion of pharmaceutical respondents said they were mulling over proposals to outsource certain internal functions (64% versus 46%) and reduce headcount (61% versus 47%). (See Exhibit 5.)

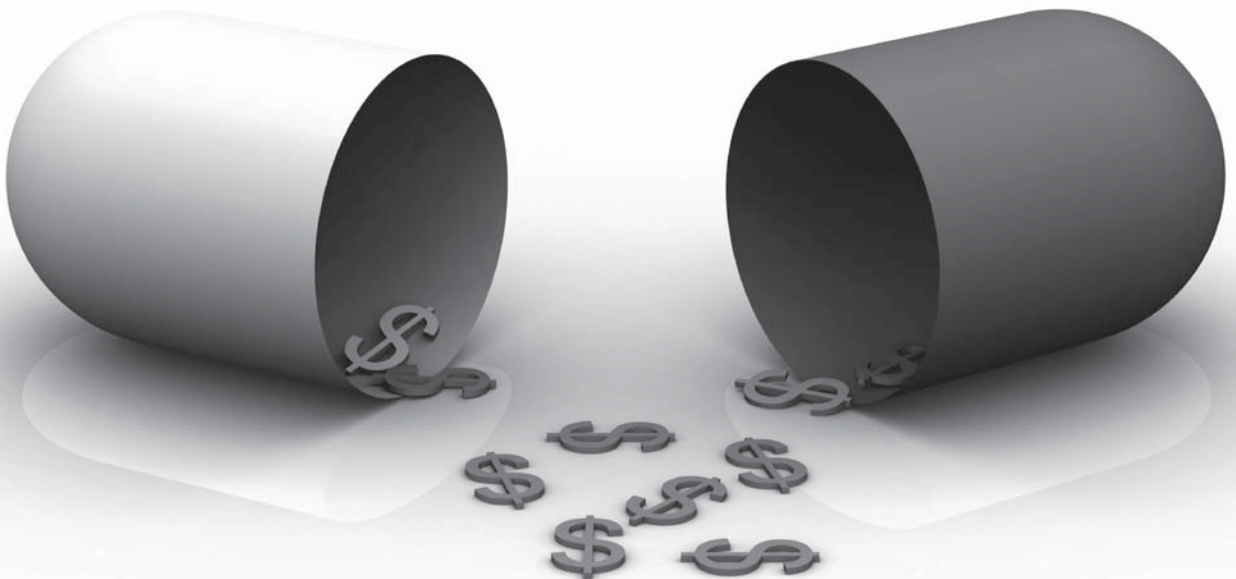
Sixty-one percent are looking at headcount reductions.

Exhibit 5: Which of the following are you currently considering as part of a cost reduction measure? (select all that apply)



The shared service approach is currently more widely used than outsourcing, and is expected to become even more broadly implemented in the future, according to the survey. One-third of respondents said they used shared services for basic finance activities such as accounts payable and expense management, while only 22% reported outsourcing these activities.

For more advanced finance activities like sales and operational planning, neither shared services nor outsourcing are widely utilized. Only 14% said they use the shared service approach for such functions, while a mere 2% said they outsource them to other parties.



Looking ahead to the future, shared services remained the preferred vehicle for cost savings, with about a third saying their companies would use regional shared services for basic finance functions (32%) and medium-to-advanced finance activities (31%). Outsourcing garnered only 21% and 12%, respectively. Citing increased risks, respondents were leery of outsourcing some key business functions to third parties.

Chief among their concerns would be outsourcing human clinical trials, with sales and marketing following closely behind. Other areas requiring more diligence included manufacturing, early-stage trials, and financial reporting (see Exhibit 6).

Collaboration

In general, the relationship between finance and other functions is good. That said, there is clear room for improvement in collaboration between the CFO's office and certain other departments, according to the survey. Compared with the responses from nonpharmaceutical companies, there was a noticeable drop in the proportion of pharmaceutical respondents who thought that most or all parts of the business received adequate management information.

Fewer than two in five (37%) respondents remarked that the finance team is doing enough to make management

information available to most parts of the business, significantly less than that reported by other industries (51%). Only 14% agreed that all parts of the business were being served well, compared with 23% in the broader survey.

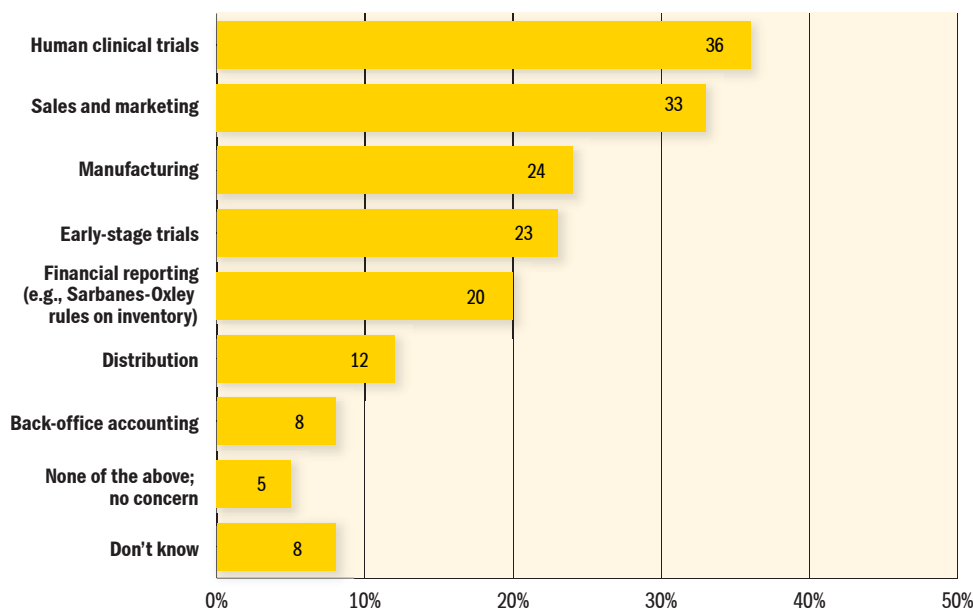
Those surveyed expressed the least satisfaction with collaboration on research and development, with only 3% describing CFO support in that area as "very effective." Human resources, sales and distribution, and marketing all received 10% or less for the highest grade. Conversely, the finance function received the highest marks for collaboration in tax (45%), treasury (40%), and procurement (24%).

For the categories of information and insight provided, 64% of respondents believed the finance function was successful at sharing financial information to support strategic initiatives, while 58% noted success in giving ad hoc advice to buttress business decisions. However, they had less confidence in finance's ability to provide nonfinancial or market information, with only a quarter (25%) of the opinion that it was successful in this role.

Across the board, pharmaceutical respondents were less favorable than their peers in other industries in assessing the effectiveness of collaborations with their finance

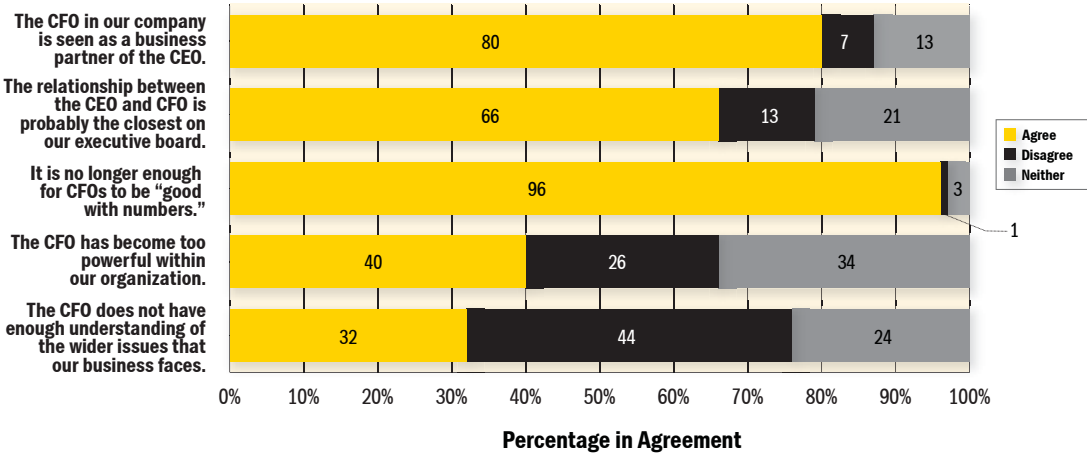
One-third are concerned about outsourcing human trials.

Exhibit 6: **If your company were to outsource the following activities, which would give you greatest cause for concern from a third-party vendor management and quality perspective? (select up to two)**



One-third find the CFO's knowledge of the business lacking.

Exhibit 7: Indicate whether you agree with the following statements



department. CFOs received the least amount of support for providing historical performance data, with only 16% calling that kind of information sharing “very successful” (versus 37% in the broader survey). Other areas where finance support fell short included accurately forecasting performance (11% versus 21%) and applying technology to provide up-to-date management information (8% versus 18%).

The results indicate that respondents may pin some blame on the people working in the finance function, as only 18% of respondents described them as “very good,” compared with 23% in other industries. Doubts also seeped into perceptions about finance’s ability to train and develop its employees, with only 14% expressing the highest degree of confidence in such programs. And while 44% of respondents expressed the opinion that their CFO does have enough understanding of the wider issues that their business faces, a significant percentage (32%) felt the opposite (see Exhibit 7).

Outlook

According to this survey the challenge is clear. Those traditional skills — being good with numbers, and acting as a scorekeeper, custodian and analyst — are still highly prized. Indeed they are seen as a pre-requisite. But they may not be enough. Either we will see CFOs operating in a pure technical accounting role or we will see them finding a way to balance the need to act as a strategic partner and to deal with the demands of compliance and corporate governance. To do that, they will need to keep the business better informed and to realize that they are expected to operate outside what may be their comfort zone, dealing with key strategic issues alongside the CEO.

Pharmaceutical CFOs are under pressure to address these new facets of their profession while confronting a significant shift in their industry overall. Based on the results of the survey, they will need to pay particular attention to collaborating more closely and more effectively with the strategic parts of the business such as R&D and marketing. The current class of pharmaceutical CFOs have an opportunity to play a significant role in defining the future of their industry and the value of their contribution to the business. ■■■■