

Survey Finds Outsourcing Practice Continuing to Mature

Jim Miller

PharmSource Information Services and *Pharmaceutical Technology's* second annual outsourcing survey indicates that **spending on contract services continues to grow**, but buyers are more selective about who they work with and the performance they expect.



BAXTER PHARMACEUTICAL SOLUTIONS

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The second annual survey of outsourcing decision makers conducted by *Pharmaceutical Technology* and PharmSource Information Services, Inc., showed a clear intention to increase spending on contract services in the coming year as well as a continued commitment to practices that enhance the performance of contract services.

The e-mail survey was conducted in June of 2003, and respondents represented the full range of CMC and preclinical development areas, but analytical chemistry and manufacturing again were the functions most heavily represented. A broad range of job functions were represented, including scientific/technical, quality assurance, project management, and outsourcing management.

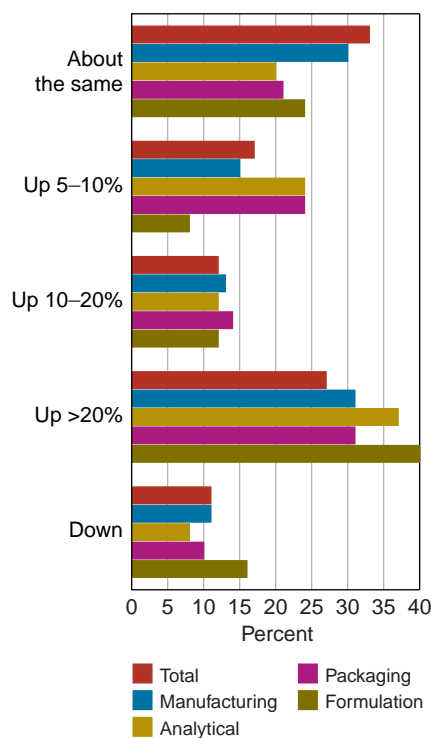
Spending way up

Respondents indicated that spending on contract services is way up this year over last year. Overall, 56% of respondents said spending in 2003 has increased over 2002, with 33% indicating that spending was about the same and just 11% saying spending is down for the year. What is really eye-catching, however, is that 27% of respondents said their spending is up more than 20% for the year. Among the CMC disciplines (manufacturing, analytical, packaging, and formulation), more than 30% of respondents indicated that spending on contract services is up more than 20% for 2003.

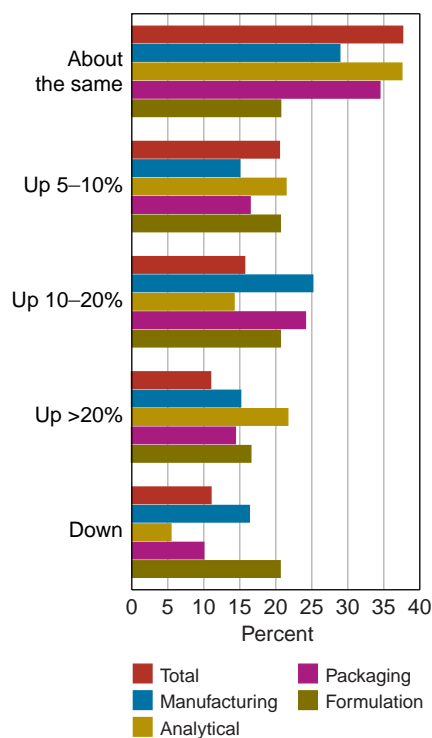
The apparent strong growth is somewhat surprising because CMC service providers have not had a great year, amid the uncertainties in funding for biophar-

Survey Results

Spending this year vs. last year



Spending next year vs. this year



maceutical companies and the effect of the Pfizer-Pharmacia merger. There are two likely explanations of the results: The responses are biased toward companies that have been most actively outsourcing their development activities, and spending on contract services started slowly at the beginning of 2003 but has accelerated throughout the year (which is consistent with the recent experience of service providers).

Survey respondents offer a promising peek at their 2004 plans. Fifty percent expect their contract services spending to increase in 2004 over 2003, including 12% that forecast spending to rise by more than 20%, which is a more optimistic outlook than respondents gave in last year's survey. Thirty-seven percent of respondents see spending remaining at about the same levels in 2004 as in 2003.

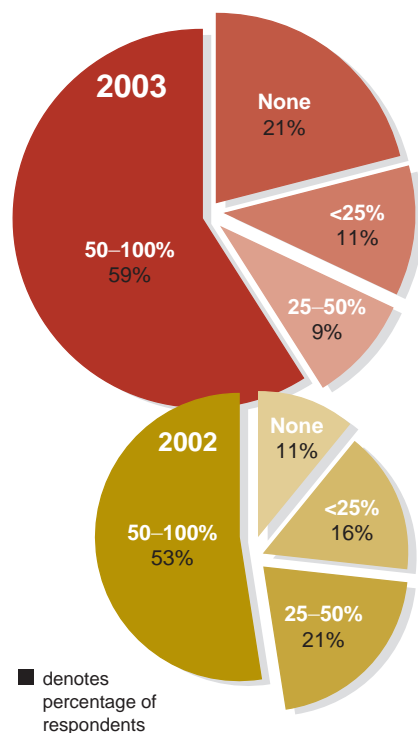
Management costs declining

The survey results indicate that pharmaceutical companies continue to make progress in learning how to manage their outsourcing programs more effectively. Most drug companies continue to view outsourcing management as a full-time discipline, with 60% of respondents indicating that their company has established a unit dedicated to managing outsourcing relationships. Typically, these units are multidisciplinary and are staffed by scientific and business (usually procurement and finance) professionals.

The trend toward concentrating spending in the hands of a few contractors is continuing. Nearly 60% of respondents say formally designated preferred providers are receiving half or more of their company's contract services expenditures. Among the CMC disciplines, preferred providers are getting more than 60%. The jump in the use of preferred providers has been especially strong in the analytical and formulation areas, in which the consolidation of spending into preferred providers jumped nearly 50% year-to-year.

The survey results also show that pharmaceutical companies are achieving real savings in the costs of managing their outsourcing programs. Sixty-four percent of respondents said that the costs of managing their outsourcing programs were less than 10% of their total spend on contract services—a jump from 52% in 2002. Only

Share of spending to preferred providers



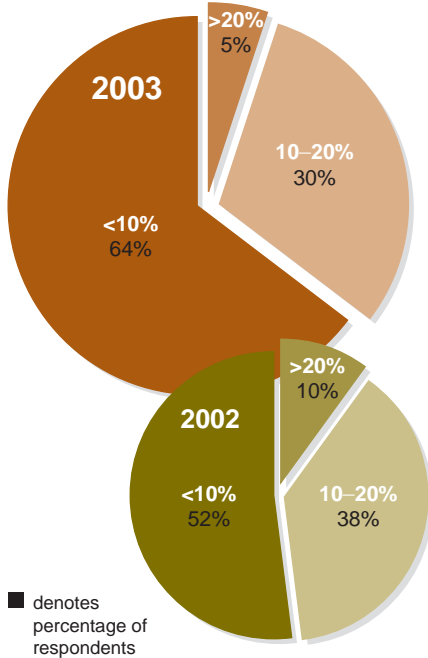
5% indicated that their management costs exceeded 20% of their service expenditures.

The most likely reason for the drop in management costs is preferred provider programs. When run properly, preferred provider programs not only reduce the costs for negotiating contracts and conducting audits, they also allow clients and contractors to establish clearer expectations and better communication channels, which should reduce the number of problems that must be resolved. Preferred provider relationships also promise substantial savings in the price of services.

Pharmaceutical companies seem to be taking performance-improvement opportunities seriously. Forty-six percent of respondents indicated that they have established continuous quality improvement (CQI) initiatives with their contract services providers, which is up from 32% in last year's survey. Manufacturing and packaging outsourcers have adopted CQI at a somewhat higher rate than analytical and formulation outsourcers, but this is to be expected given that those areas usually involve large multiyear programs. The adoption of CQI programs indicates that those companies are committed to long-term relationships with their service

Survey Results

Management cost as % of spending



providers and signals a move to a more strategic approach to outsourcing.

One area that is not yet contributing to outsourcing management cost savings is e-procurement technology. Seventy-three percent of respondents say they are not using e-procurement technology in any form in their outsourcing management efforts. Among those that are adopting e-procurement, most (15% of all respondents) are using it just for purchase-order generation, a few (5%) are conducting online competitive bidding, and just 6% are using e-procurement for both of those activities.

Pharmaceutical companies continue to be lax about financial due diligence, although they are getting better. The share of respondents who said they never or only sporadically review contractor financial statements remained constant at 43%. Although the number of respondents who said they conduct due diligence at the initiation of the relationship jumped to 43% in 2003 from 25% last year, the number of respondents who review statements annually dropped by nearly half, from 30 to 17%.

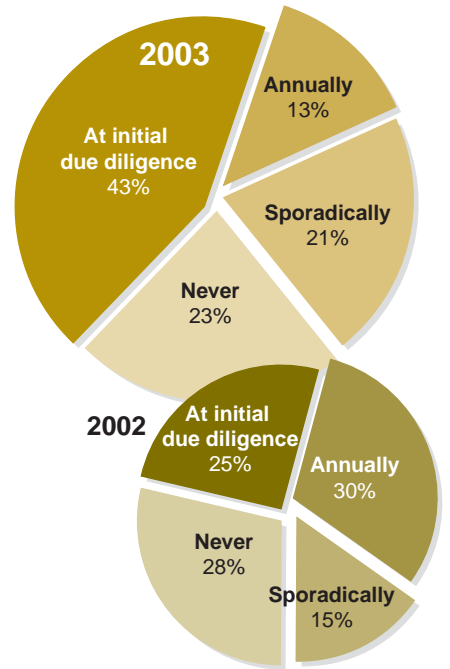
This lack of ongoing due diligence leaves clients very exposed. More of the contract services business is concentrated in the hands of large publicly owned companies, but private companies still play an important role in the outsourcing programs of most drug companies. Furthermore, even publicly owned companies can experience operating and financial problems that may result in an impairment of performance or a change of control (e.g., an acquisition or merger).

Implications

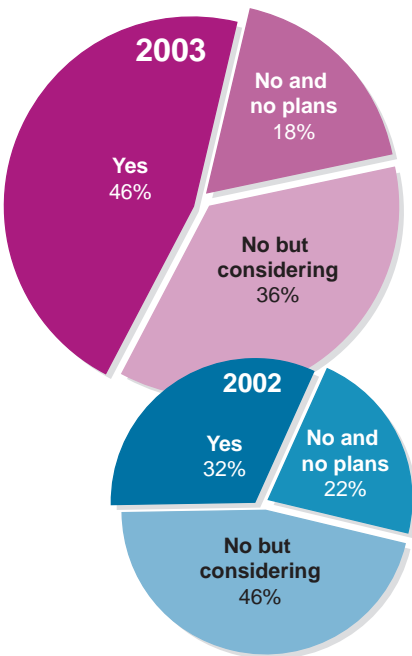
This year's *Pharmaceutical Technology*-PharmSource outsourcing survey confirms the continued strength of drug companies' commitment to contract services and the ongoing evolution of management practices. To keep up this trend, both clients and vendors must continue to look several steps ahead as they plan their development and manufacturing strategies.

Focus on performance. The survey results indicate, and industry experience confirms, that performance matters most. Drug companies are more focused than ever on the ability of their contractors to

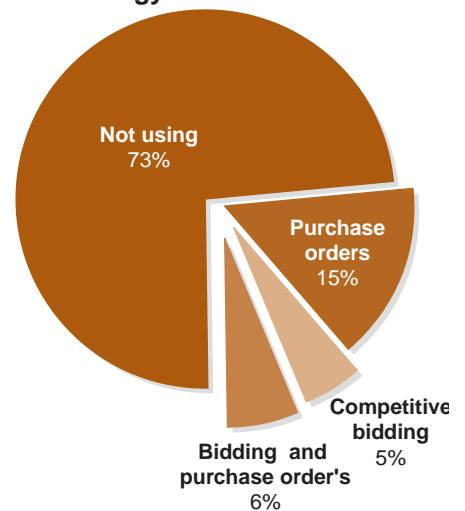
Financial statement review



CQI program

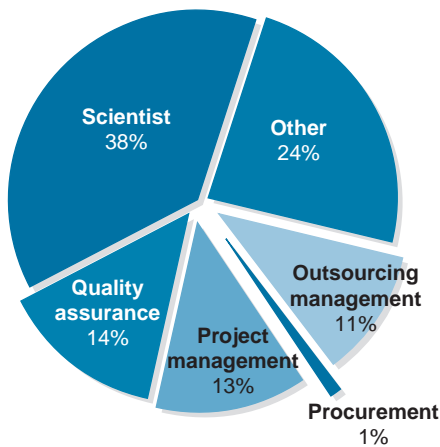


Use of e-procurement technology



Survey Results

Job function



deliver timely high-quality results at a fair price, and they are willing to invest in long-term relationships to achieve those results. Contractors should focus on how to deliver that performance and perhaps spend less time devising “value-added” strategies aimed at boosting margins. Reliable performance is the most valuable benefit that contractors can provide and delivering it builds dependable long-term relationships that are necessary for sustained profitability.

Manage risk. Risk management is a hot topic in the pharmaceutical industry these days, and drug companies should be trying to practice more of it in their outsourcing relationships. Financial due diligence and CQI are just two elements of a broader risk management approach that can prevent or at least moderate the effect of events that interrupt service relationships and threaten development programs and supply lines.

Look beyond the pharmaceutical industry. The best practices in outsourcing are not found within the pharmaceutical indus-

Reliable performance builds dependable long-term relationships and is the most valuable benefit that contractors can provide.

try. Rather, drug companies should be looking at the experience of companies in the electronics, automotive, and IT industries to find the strategies and procedures that will enable them to get the most out of their outsourcing efforts. **PT**