Harnessing procurement as a post-crisis change engine

Photo by Rodey Wing
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The (procurement) challenge

While the COVID-19 crisis has caused unprecedented distress to businesses and individuals, it has also moved the health industry into the spotlight. Never in recent history has its role in the well-being of our societies been more fundamentally obvious. However, the resulting, more-supportive environment comes with an expectation for the health industry, and there have been specific challenges, too. Though top-line revenues were less of a concern than in other industries, the health industry has struggled with securing certain supplies and adjusting capacities to surging demand—procuring protective equipment and disinfectants at a multiple of the capacity previously installed, or securing supply of medicines that largely depended on raw materials from China or India, where supply chains were first interrupted, became a serious problem. At the same time, pharma companies saw unprecedented cuts in their own demand; reducing spend on sales representatives' services by 50 percent, using 80 percent less office space, and virtually eliminating travel are just few examples. The key learning from all this is that despite new ways of working that were unthinkable just a few months ago, the business is still running. Quite well, even.

Now is the time to scrutinize procurement processes. Not only does it manage 30 to 50 percent of a pharma company's total external spend, but it also has a key hub function—procurement represents a cross-section of all external demands that a company has. In that sense, it is a crucial internal business partner to all other functions, and it literally fights at the forefront of implementing key efficiencies, such as changing footprint and reducing risk of supplies, finding an accepted way of qualifying new suppliers remotely, and identifying and engaging with nontraditional suppliers. In other words, where the crisis is a catalyst for change, procurement is an engine to drive value from that change.

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The sage new world

How can procurement help to drive competitive advantage in tomorrow's world? How can the "forced learning" from the crisis be turned into competitive action by reshaping external supply relationships? Many of the changes witnessed during the crisis are likely to stay, and they will have an impact on the future spend footprint of pharma companies. Here are a few key examples:

— Use of **digital tools and media** will further accelerate and trigger new operating models, especially in the area of sales and marketing. Medical in-person conferences will be increasingly replaced by remote formats, cutting demand for related travel and event management services. On the flipside, digital platform and content providers will see a surge in demand. This will all lead to a major structural shift in sales and marketing spend.

— Preference and acceptance of **virtual connections and work-from-home models**, successfully tested during the crisis, will increase, throwing into question the need for large office spaces and equipment, corporate fleets, and travel in general.

— **Global islandization** will increase. COVID-19 showcased the vulnerability of concentrated global supply chains. The fact that the number of active pharmaceutical ingredients (API) manufacturing facilities in China doubled from 2010 to 2019, and that 80 percent of the world's APIs are produced outside the US, most of which are sited in China and India, gives just a glimpse of the challenges from a US perspective. In the past, companies pursued multi-sourcing strategies to secure capacity. Now, there will be a focus on geographic diversification of supply chains to make them more resilient.

— The **availability of healthcare professional (HCP) partnerships** will become more restricted, triggering a review of operating models. Use of traveling sales representatives will go down, whereas remote engagement with HCPs through digital platforms will increase, driving demand for the related technology and agency services—underpinning the expected change in marketing mix and spend.

— Finally, we expect greater **openness for structural change** in general. New ways of working, forced by the pandemic, have created a business environment that is more supportive of lean and agile operating models. This can include innovative ways of working with suppliers, including extended use of external workforce models and remote collaboration.

The (procurement) value engine

A courageous and focused effort now will be essential to ensure procurement teams are running at full speed after the crisis, when the dust has settled. A simple yet effective framework for commercial category excellence provides guidance on which areas procurement should tackle, when, and how (see figure 1 on page 3).

The first assessment dimension is the **criticality of the spend category for the ongoing business**, ranging from "discretionary," where canceled or delayed purchases would have virtually no immediate business impact, to "essential," where missing supplies would literally stop operations. The second dimension is the **favorability of commercial intervention**, ranging from "low" for constrained markets to "high" where suppliers have over-capacities and are seeking to secure their order books for the future. Overall, we see three clusters of spend categories:

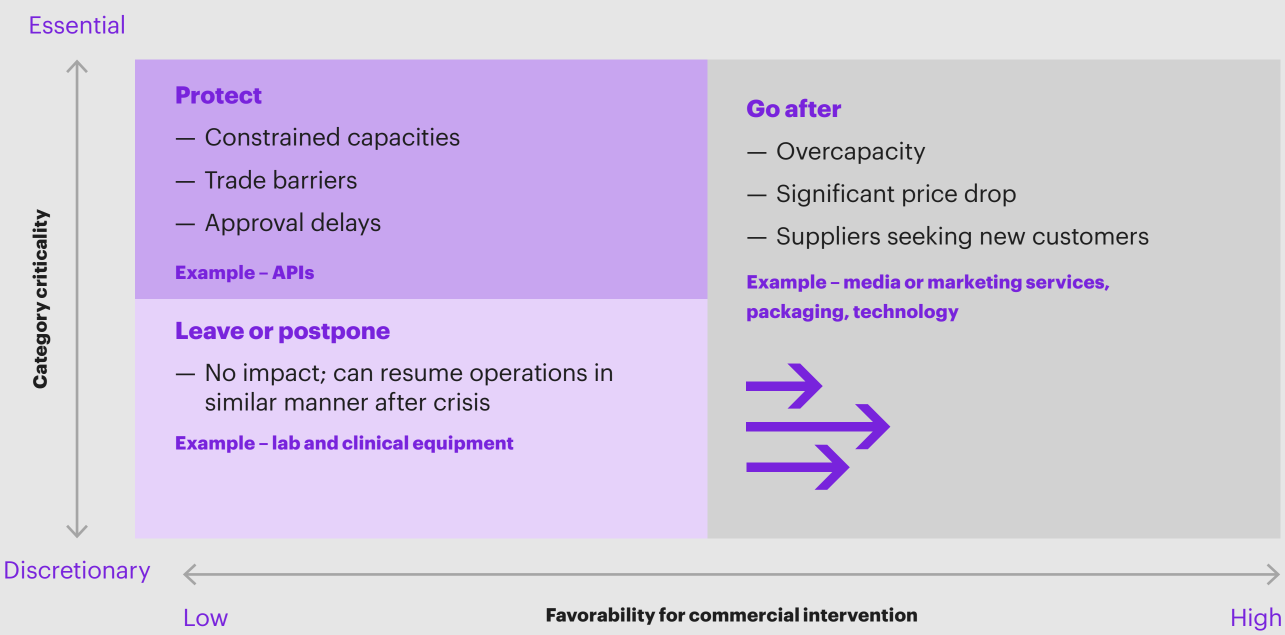
1. **"Protect"** categories, where the demand situation is business critical and fixing supply security risk is an immediate imperative, even if the situation may not be favorable for commercial intervention. Examples are APIs, third-party manufacturing, and personal protective equipment. Measures for this cluster range from inventory buildups, as seen for bioprocess materials and glass containers where markets got highly constrained, to emergency funds or supplier financing programs for vendors in distress, to a broader restructure of the supplier network based on agility and crisis response criteria. The latter also includes, next to geographic diversification, the introduction of nontraditional suppliers, as well as the acceleration of supplier approvals through more agile, remote process steps and cross-company sharing of related (non-sensitive) data.

2. **"Go after"** categories, where the situation is favorable enough for commercial intervention to seize the opportunity, irrespective of the category's criticality. Those companies with high demand power should use their existing advantage by engaging with suppliers in open book profit and loss discussions and resetting the terms of engagement, or by realizing commodity price advantages. Where demand power is low, "go after" strategies require mindset shifts to find ways of creating advantage, such as advance purchases of goods or services, joint investments to create win-win situations, or even selective acquisitions. Examples of "go after" categories are marketing services and media spend categories, facility- and travel-related categories, and IT/technology and external workforce.

3. **"Leave or postpone"** categories, which are neither crucial nor see a favorable environment. These can be taken care of at any time and should be left as they are, so attention and resources can be focused on the other two clusters.

However, positioning of the spend categories can shift over time. Some categories—examples can be found in primary packaging—with tight markets caused by demand hikes at the beginning of the crisis have returned to normal or their demand has even slowed. Logistics services in general, and freight forwarding in particular, are other good examples: Capacities were extremely constrained due to traffic restrictions, closed borders, and a shortage of drivers at the beginning of the crisis, making it almost a "protect" category then. Now, with those initial problems resolved, logistics services offer very attractive optimization opportunities due to low energy cost and the need to re-think the supply network, turning it into a clear "go after" category.

Figure 1
A commercial category excellence framework can help procurement teams prepare for a post-crisis world



Source: Kearney analysis

This includes tactical levers to create financial headspace for new investments as well as strategic levers to establish new agile and more resilient supply structures for the future (see figure 2). The **tactical levers** should be pulled immediately, for fast cash impact: scrutinizing demand policies and driving zero-based budgeting for categories such as events, training, real estate, and office utilities can be implemented instantly. The same applies for revamping commodity price risk management for exposed categories such as chemicals, utilities, freight, and some packaging categories. However, longer-term **strategic levers** also need to be tackled now. A series of investments, to enable new operating models, will require major procurement support across many categories—for example, the purchase of IT technology and services as well as content for digital collaboration all along the value chain, including R&D activities, supply chain transparency, and digitized sales and marketing approaches. Also, a restructured supplier network that potentially involves disaggregation and localization, make-or-buy programs, or even targeted acquisition efforts will take time.

The time for the procurement engine to shift gears is now. It will be a driving force for realizing value when the dust has settled.

Figure 2
Acting now will unlock tangible and strategic value after the crisis

Examples – non-exhaustive

	1–3 months	Beyond 3 months
Tactical	**Advance purchases** Media and placements, raw materials	
	Zero-based budgeting Events, training, real estate, office utilities	
	Commodity price risk management Packaging categories, chemicals	
Strategic	**Acquisitions** Big data or analytics expertise	
	Operating model shift Build capabilities in digital collaboration, undertake investments for fast-track drug approval	
	Supplier network rethink Review direct supplier network—localize, disaggregate, bring intermediary	

Source: Kearney analysis

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