Life Sciences Consulting Insights

Is the sector recession proof?

A business & technology overview

Special Edition

—

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Executive Summary

Welcome to the special edition of KPMG Life Sciences Consulting Insights.

In this edition, we bring to you an in-depth analysis on how the life sciences (LS) sector is likely to be impacted by the oncoming potential recession, and what should be LS firms' actionable strategies to not just survive — but thrive — by the end of this difficult period.

The global economy has experienced concurrent economic blows in the last three years, and with the recent sudden collapse of high-profile financial institutions (Silicon Valley Bank (SVB), Signature Bank, and Credit Suisse), several industry leaders foresee a minimum of six to eight months of mild recessionary pressures atleast.

However, historically, LS sector has stood tall in the face of economic uncertainties on account of its inelastic demand and general support provided by global regulatory bodies.

A key indicator of the sector's recession-proof nature is its performance in the Great Economic Recession between 2007 and 2009 — during which the industry witnessed a fall in overall R&D spend and a few layoffs but remained largely unscathed.

However, only a few of the strategies employed back then may be effective in the highly competitive, tech-driven LS industry of today. For instance, the potential banking contagion could impact the capital raise plans of early-stage companies and small and mid-sized enterprises (SMEs), triggering a shift in strategic priorities. On the other hand, LS firms with strong balance sheets might look to acquire interesting biotech targets with strained balance sheets.

Thus, in this special issue, we dive into the anticipated impact of the looming recession and compare it with the Great Recession of 2008 to identify relevant actionable strategies from the past and recommend new ones likely to be helpful in the future.

Key strategies detailed upon on this issue include the following:

- Optimization of product and service portfolios
- Revision of inorganic growth strategies
- Construction of resilient supply chains
- Strategic incubation of digital tools

Get in touch with KPMG, Consulting, and our global community:

KPMG is a trusted advisor in Life Sciences consulting, working together with clients from global players to start-ups to drive tech-enabled business transformation, realize operational and financial resilience, and become future-ready.

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The industry is preparing for a challenging economic period. While some players are focusing on business continuity through cash flow optimization, cyber security or supply chain resilience, others are seeking the right M&A strategy or strategic R&D alliances to emerge from the crisis with maximum success. There is no one-size-fits-all strategy. However, every recession brings forth a set of risks and opportunities for growth that can benefit all stakeholders involved. 2023 could prove to be a pivotal year for some Life Science companies, if they revisit their strategic priorities to navigate the recession roadblocks.

Ashish Madan
Partner, Consulting

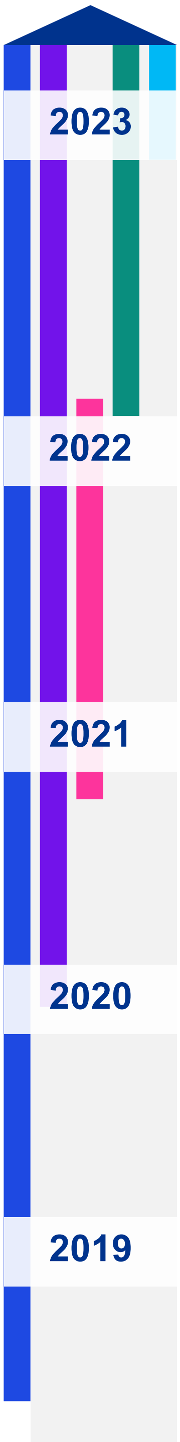
The Market Lens of Economic Downturn

Why is the recession anticipated to have some impact on the LS industry?

With the global economy facing concurrent uncertainties due to rising inflation, failure of key financial institutions, persistent supply chain bottlenecks, geopolitical uncertainties and evolving business models, the idea that the LS industry is recession proof is being put to test.

Factors leading to recessionary risks

Concurrent economic and geopolitical blows leading to increased production costs and lower profit margins



Banking crisis

Recent collapse of SVB, Signature Bank, and Credit Suisse may initiate fears of a wider contagion among investors and impact biotech valuations, further escalating worries of a slowdown.

Geopolitical instabilities

The Russia-Ukraine war severely impacted global pharma companies relying on Ukranian molecular libraries for preclinical drug development, as well as clinical trials.

Further, crude oil and natural gas prices have skyrocketed since then, leading to a major rise in already strained drug production costs.

Additional drug pricing regulations

Government-driven drug pricing control acts, such as the IRA*, and the ongoing pricing control system in Europe, are cutting pharma companies' profit margins and discouraging additional investments, leading to drug shortages.

Tender systems and pricing regulations on generics are forcing European drugmakers to shift operations to Asia.

Trade obstruction and container shortages

The blockage further disrupted global trade, and impacted supply of essential commodities, such as medical/ surgical supplies & PPE* kits.

Additionally, prices of APIs*, packaging and sea freight rates increased exponentially, leading to rise in input costs and reduction in margins of drug maufacturers.

Global pandemic

Stringent lockdowns further strained the precarious supply chains, forcing firms to revisit operating models to reduce dependence on human resources and distant suppliers.

Other industry functions (e.g., healthcare and CROs*) were also severely impacted, as adoption of virtual clinical trials accelerated, hospitals/ HCPs* were overburdened, and elective procedures hit a slump.

Trade conflicts

Rising tariffs induced by trade war led to an increase in raw material and drug prices, thus putting pressure on healthcare goods manufacturers, providers and patients

This drove manufacturers to explore alternative sources of raw materials such as APIs*, to keep a check on prices of prescription drugs.

Note: *Concept defined in detail in glossary
Source: KPMG, Germany, 2023

Impact on Life Sciences Value Chain

Impact on value chain – How impressions in 2023 compares to 2008's Great Economic Recession?

The Great Economic Recession marked an inflection point in pharma industry history whose effects – though modest – were felt across the value chain. Experts believe that the current economic environment is likely to have similar but less drastic effects on different functions.

Past Experiences		Future Expectations
Contrary to its ever-increasing trend, growth in R&D spend flatlined between 2008 and 2011, as major companies allocated fewer resources to R&D than expected; however, smaller and mid-sized biotech firms that relied on external funding, had to cut back on R&D investments to optimize cash flow	**Drug R&D/clinical trials**	Given the recent financial crackdown, a similar strategy may be useful for SMEs in 2023, with CFOs looking for alternate, short-term lines of credit & working capital to avoid disruptions; large pharma companies are more likely to pursue innovation and to prioritize R&D, capitalizing long-term gains
Most companies tackled manufacturing-related issues in 2008 by outsourcing labor-intensive activities, such as formulation development and clinical drug manufacturing, to CROs, resulting in expansion into low-cost emerging markets, such as India and China	**Manufacturing and supply chain**	However, this strategy may not be of use in the current scenario, which requires companies to shorten supply chains and reduce production costs to tackle inflation; thus, companies are expected explore new strategies, such as incubation of digital tools, to intercept manufacturing and supply chain issues
Top pharma players retained sales and marketing costs during the 2008 recessionary pressures; however, there were massive lay-offs in several companies, including Pfizer, Abbvie and Merck, across teams as companies anticipated losses from an impending patent cliff	**Marketing and sales**	Currently, a few pharma companies are looking to initiate layoffs and exploring new ways to reduce SG&A* costs; e.g., Novartis plans to cut approximately 8,000 jobs globally by 2024 (limited information available w.r.t the profiles/departments that may be targeted)

"The effects of the oncoming potential recession are likely to mirror those of the setback in 2008 but are unlikely to be as extreme. Following 2008, companies dealt with manufacturing and supply chain bottlenecks by expanding — and eventually, globalizing — their upstream and downstream value chains. In the current situation, on the contrary, regionalized and technology-enabled agile and supply chains are the way forward to resilience."

Kaveh Taghizadeh

Partner, Consulting

Note: *Concept defined in detail in glossary
Source: KPMG, Germany, 2023

Impact on Life Sciences Stakeholders

Impact on stakeholders – How different key players in the LS Ecosystem would feel the heat?

The LS industry is highly heterogenous, which is why it is unwise to generalize the impact of the oncoming recession across stakeholders. However, there is consensus that small biotech firms and generics manufacturers are more vulnerable in economically difficult times, compared with major pharma companies. This is likely to hold true for 2023 as well.

Healthcare providers (HCPs)

Low ▲ High

- Traditionally insulated from economic headwinds, HCPs may be moderately impacted by the oncoming recession on account of recently contracted profit margins and COVID-19-induced workforce turnover
- Further, the industry is still recovering from the effects of COVID-19, which popularized new operational models (e.g., telemedicine) and impacted businesses negatively

Biotech SMEs & start-ups

Low ▲ High

- As observed in earlier times, smaller biotech firms may be forced to resort to cost optimization measures, such as curbing R&D programs and laying off key personnel, to stretch their cash runways. This is crucial for early-stage biotech startups, especially after the fallout of SVB and Signature Bank, considering a significant portion of their customer base was focused on US venture-backed technology and life science companies
- Among these, firms that own late-stage drug assets or products with proven business cases may fare better than others (for example, those focused on preclinical assets)

Payers and PBMs*

Low ▲ High

- Payers and pharmacy benefit managers generally fare better at facing economic uncertainties, since their reimbursement rates are negotiated with governments and pharma companies on a multi-year basis
- Further, an increasing number of payers are diversifying their businesses to boost resiliency (for instance, by offering pharmacy and health information services)

"SMEs (such as biotechnology companies) are likely to be most affected by an economic downturn, especially those that rely on investments from venture capital firms and external investors. The biotech market has seen some major bear runs followed by bull runs in recent years but has recovered each time. There is an increasing pressure for SMEs to optimize cash reserves and cash flow as well as exploring win-win collaboration models with larger players in the field."

Roger van der Heuvel

Partner, EMA Life Science Strategy Lead

Note: *Concept defined in detail in glossary
Source: KPMG, Germany, 2023

Impact on Life Sciences Stakeholders

Generic manufacturers

- Generic manufacturers are generally hit harder by recessions due to lower profit margins associated with generics and more competition in the sector
- In the current scenario, this negative impact is likely to be exacerbated by the unyielding nature of regulatory bodies w.r.t price controls, even in the face of snowballing production costs

Specialty pharma firms

- Major pharma businesses were relatively unimpacted by past recessions due to their ability to hold inventory, explore new suppliers and pass on the increase in costs to other stakeholders in the value chain
- While rising inflationary and regulatory pressures may impact their margins soon, they continue to be strongly positioned compared with other stakeholders

Patients

- Patients may be negatively impacted by the recession on account of a likely fall in household disposable incomes, limiting their ability to access proper healthcare
- Several patient groups may then look to minimize spending on elective procedures and overall health measures, and seek public health support to procure prescription medicines

> *"The volatile market situation is driving corporates to shift their focus towards business continuity and supply chain resilience. For us at Aenova, we are adopting technological solutions targeting operational excellence powered by digitalization on the shop floor and commercial data analytics. In the life sciences ecosystem, our top priority continues to be strong, sustainable customer relationships and value creation."*
>
> **Damir Juricic**
>
> VP Corporate IT / CIO Aenova

Note: *Concept defined in detail in glossary
Source: KPMG, Germany, 2023

Focusing on Strategic Priorities

Navigating recession roadblocks through strategies that realize sustainable business outcomes

To effectively battle the oncoming economic slowdown, LS firms may need to revisit their strategic priorities and focus on cost optimization along with revenue expansion.

KPMG has identified four key focal areas that can help LS firms effectively tackle the oncoming recession, while helping them prepare for an even more competitive and connected future.

Optimizing product and service portfolios

At the end of this uncertain time, companies with the leanest operating models and product portfolios are likely to be better positioned than their diversified counterparts. Thus, firms may be required to make hard decisions in terms of shedding low priority assets and shifting focus to high-priority assets to achieve agile operations, while freeing up cash to retain investor trust.

Revising inorganic growth strategies

Instead of being risk-averse, pharma companies may benefit from focusing on resilient and long-term growth to capitalize on strategic opportunities through acquisitions, mergers and/or joint ventures. With valuations likely to hit record lows, companies should look to invest in high-impact solutions, such as phase 2&3 drugs and decentralized trial-related technologies to remain competitive.

Building resilient supply chains

Pharma supply chains, while becoming lean and efficient, have become increasingly vulnerable to disruptions as players have consolidated and externalized manufacturing and expanded supplier networks. In this landscape, building resilient, digitally-enabled supply chains is emerging as a key strategy to manage risks and address logistics-related challenges.

Enabling strategic incubation of digital tools

Tech-driven cost optimization is likely to emerge as a key value proposition and should be considered a priority by firms looking to lower production costs and build more resilient and transparent supply chains. Besides, new-age digital tools can help LS firms achieve efficiencies and reduce costs associated with previously unexplored functions, such as SG&A, while adding value to their evolving product and service portfolios.

Source: KPMG, Germany, 2023

Strategic Priorities for LS Firms in 2023+

Navigating recession roadblocks through strategies that realize sustainable business outcomes

Optimizing product and service portfolios

01 Despite lowering investments in R&D, the pharmaceutical industry witnessed extensive collaboration and M&A activity between 2008 and 2011, as companies looked to capitalize on developed assets to bolster pipelines in the face of an oncoming patent cliff

02 However, in today's economic environment — constrained with inflation, potential banking system vulnerabilities, and geopolitical uncertainties — large companies are likely to benefit from prioritizing specific products and services and spin-off businesses that do not align with their long-term strategy

03 This is likely to help companies transform their operations to become lean and agile, while generating free cash flow for stakeholders in the near term

04 Within drug pipelines too, companies can look to focus on specific drug candidates and/or therapeutic areas, and de-prioritize high-risk pre-clinical assets, which are unlikely to help them capture the market in the next 3-4 years

Case-in-point Teva's initiatives towards business optimization

- Teva has been optimizing its product portfolio through various initiatives, including divesting non-core assets and focusing on its core strengths, such as complex generics and biosimilars
- The company is planning to ramp-up production of biosimilars, with an aim to secure a 10% global market share in biosimilars. Teva currently has three approved biosimilars, while 13 are in development
- Recently, the Teva-Takeda joint venture offloaded most of its generics portfolio and a manufacturing site in Japan to shift its focus to a smaller core of specialty drugs and targeted generics

Our business models are slowly, but surely, changing. To tackle the forthcoming recession while keeping the patient's experience in mind, we must leverage smart digital solutions and invest in technologies such as AI to enhance R&D. Transformative technologies are central to growth, innovative ambitions and a patient-centric digital service portfolio.

Asaf Gal

Global CIO Teva Pharmaceuticals

Source: KPMG, Germany, 2023

Strategic Priorities for LS Firms in 2023+

Navigating recession roadblocks through strategies that realize sustainable business outcomes

Revising inorganic growth strategies

01 M&A activity was not significantly impacted in 2008 as the industry witnessed at least a few megadeals to acquire low-risk, high-impact assets (e.g., Roche—Genentech and Merck—Schering-Plough, and Pfizer—Wyeth)

02 Currently, too, most LS officials state that M&A is likely to remain a key focus area, driven by the need of companies to cash in on record-low valuations (especially biotechs with ties to SVB and/or other strained banks) and invest in upcoming technologies to maximize long-term gains

03 However, there is consensus that much like 2008, companies will look to prioritize late-stage high-yielding investments with an established market and/or business case instead of early-research-stage assets to balance risks

Key assets likely to attract major pharma companies and PE investors

- **Phase 2&3 drug candidates** that can help bolster pipelines and accelerate new launches
- **Lean manufacturing systems** that can lower production costs and boost profit margins
- **Decentralized trial tech** that eases trial management and helps reduce time to market
- **Patient-engagement tools** that can help firms retain customer base in the long term

> *With biotech valuations expected to decrease further, at least for smaller scale drug developers, it is unlikely that pharmaceutical companies and biotech venture funds will de-prioritize M&A activities. On the contrary, this could be a great opportunity to find potential diamonds in the rough, acquire them at reasonable valuations and speed-up innovation to catch up on R&D.*

Meino Müller
Partner, Deal Advisory

Source: KPMG, Germany, 2023

Strategic Priorities for LS Firms in 2023+

Navigating recession roadblocks through strategies that realize sustainable business outcomes

Building resilient supply chains

01 While LS firms resorted to outsourcing effort-intensive activities, thus bolstering the CRO market and globalizing supply chains in 2008, the current scenario will require them to revise sourcing strategies and incubate new technologies to build robust and resilient supply chains fit for the future

02 Key actionable steps that can help companies minimize risks in the short term include increasing on-site inventory and exploring alternative sourcing options to minimize shut-downs in case they are cut-off from their suppliers due to unforeseen circumstances

03 Besides, they can look to digitalize their supply chains by investing in high-end solutions, such as AI-enabled supply and demand forecasting tools, and blockchain-based collaboration systems, that can secure and analyze large amounts of unstructured data to yield actionable insights for value creation

Case-in-point Bayer's future-ready supply chain

- Bayer has been working towards creating a more agile, resilient, and responsive supply chain by leveraging sophisticated technologies such as cloud computing, blockchain, and IoT
- The company collaborated with VeChain to incorporate a blockchain-based traceability platform (Csecure) for capturing its clinical trial supply chain data
- By creating a tamper-proof digital ledger of all transactions, blockchain allows Bayer to track the movement of drugs from point of manufacture to point of consumption, thus, improving inventory management, reducing counterfeiting risk, and enhancing patient safety

As a diversified company, Bayer has one of the most complex supply chains in the Life Sciences industry. It's vital that we maintain our resilience, keeping our promise in sustainability, across our suppliers and logistics partner ecosystem. We also realize that, to be future-ready, a technology-backed supply chain foundation can ensure speed-to-market, real-time traceability, and predict disruptions, while helping us minimize our risks.

Bijoy Sagar
CIDO Bayer

Source: KPMG, Germany, 2023

Strategic Priorities for LS Firms in 2023+

Navigating recession roadblocks through strategies that realize sustainable business outcomes

Enabling strategic incubation of digital tools

01 In contrast to the times of the Great Economic Recession, the LS industry today is well on its path to digital transformation with companies focused on rapid identification of new business cases for tech-driven cost optimization; this is likely to remain a key focus area as companies battle economic and geopolitical uncertainties in the near future

02 However, firms should look to adopt a phased approach to digital transformation, prioritizing investments focused on establishing a solid IT foundation and/or cost optimization in the short term, while pausing effort- and resource-intensive initiatives

03 Besides, companies should look to monitor regulatory changes related to tech incubation and prioritize investments in cybersecurity tools to remain compliant

Key technologies companies can look to incubate in the near future

- **Internal function automation** tools to streamline mundane internal processes and lower SG&A costs
- **Supply chain monitoring** tools to help firms forecast supply and demand, and prepare for likely disruptions
- **Smart manufacturing** systems that can help firms lower drug production costs and recover profit margins
- **Cybersecurity-oriented tools** to safeguard confidential data while ensuring regulatory compliance

In light of the recent Russia-Ukraine conflict and the impending recession, it is imperative that pharmaceutical companies invest in cutting-edge cybersecurity technologies to fortify their defenses against cyber-attacks, ensure the continuity of services to safeguard intellectual property, and preserve the integrity of their supply chains. CyberTech Solutions are vital components of an organization's digital foundation and rapidly ongoing digital transformation, helping organizations mitigate risks and retain stakeholder trust in these uncertain times.

Marko Vogel

Partner, Consulting

Source: KPMG, Germany, 2023

Glossary

API

An Active Pharmaceutical Ingredient (API) refers to a substance in a drug composition that directly affects the ailment or targets the disease.

CRO

A Contract Research Organization (CRO) is a service organization that supports pharma, biotech, and medtech industries by providing several research-oriented services, such as pre-clinical drug development and clinical trial management.

HCP

A Health Care Provider (HCP) refers to a group of people and institutions, which includes individual doctors and healthcare facilities, such as hospitals, pharmacies and clinics, that provide healthcare diagnosis and treatment services to patients.

IRA

The Inflation Reduction Act of 2022 is a US federal law aiming to curb inflation via reducing national deficit, decreasing prescription drug prices, and cutting down carbon emissions while investing in green technologies.

PBM

Pharmacy Benefit Managers are third-party administrators that manage several prescription drug reimbursement programs, including government- and employer-provided plans, to help patients procure prescription drugs at optimal prices.

PPE

Personal Protective Equipments (PPEs) refers to safety gear (such as protective clothing, helmets, gloves, etc.) designed to protect healthcare workers by minimizing exposure to infectious materials.

SG&A

Selling, general and administrative (SG&A) expenses are the everyday operating expenses of a business, that are not assigned to a particular product. These include costs such as rent, marketing and advertising, sales and accounting, and administrative salaries.

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