The mouse that hunts for Life Sciences companies

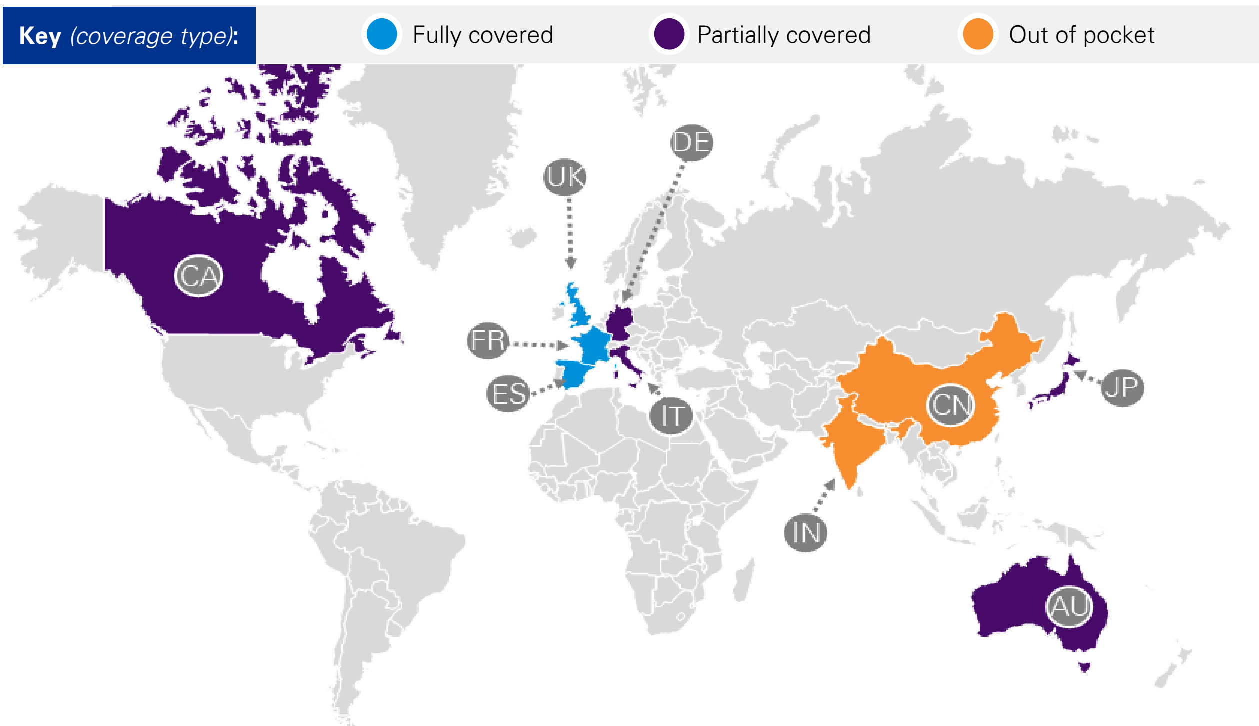
Gross-to-Net (G2N) thinking in the Asia-Pacific

The Life Sciences industry in the Asia-Pacific is highly-complex. A large, diversified region with significant unmet healthcare needs, the Asia-Pacific is often seen as a growth driver for companies. But a spaghetti web of new products, old products, partnership and distribution channels, multiple funding sources, and cultural dynamics can make operating here a challenge. And a potential fatal flaw is to focus only on the top line when comparing results.

As pricing is a sensitive topic for the Life Sciences industry, we will not attempt to politicize it. One thing is certain though – there is increasing price transparency for all stakeholders in the ecosystem, which makes the process of price setting and reference pricing across markets even more important. Companies must more closely monitor the discounts being applied country-by-country, not only for compliance purposes but also to ensure a viable, sustainable business model.

For such a topic, the devil is truly in the details. To stay on top of the situation correctly, a multitude of concurrent dimensional attributes require analysis. Analysis that is beyond the realm of possibility for human calculation, and even most standard databases being used. This article covers the latest in Gross-To-Net (G2N) thinking, and why this is a critical capability for any Life Sciences organization seeking success in the Asia-Pacific.

Example: relative market dynamics that could affect pricing behaviors



G2N defined, the art and the science

In return for the products and services provided, Life Sciences companies (expanded to consider stakeholders across the value chain) utilize a mixture of direct and indirect discounts, or on-invoice reductions in list price, and rebates, or off-invoice reconciliations at the end of a period, alongside other investments such as patient programs (support as well as affordability), commissions, distributor fees, free-of-charge goods, returns, and claw-backs, to name a few. The sum together is G2N, the difference between gross and net sales. **And it can be significant – we've observed overall net impact to sales up to 55% for the Life Sciences industry, especially in markets where there is significant price pressure or price reduction mechanisms such as government price controls. For the top 10 pharmaceutical companies globally, G2N equates to more than USD 50 billion. What's more, up to 35% of SKUs and 30% of customers have been found to be "value-negative" in terms of net profitability.** We increasingly observe G2N becoming enrolled in statutory audits due to the high concern with the financial reporting vulnerabilities that this brings.

Ultimately, G2N becomes a driver of stakeholder behaviors based on the delivery targets and incentives therein. Value chain players may use G2N offsets to finance their own operations, such as channel margin or promotional activities. Surprisingly, the nature of discount and rebate oscillation is often ignored. For example, a Life Sciences company may have a high G2N but pass on the margin enhancement to the next stakeholder in the value chain, which becomes just another standard pricing strategy.

This paper argues, however, that such a passive approach to G2N will no longer suffice. Value chain consolidation, shifts in power positions, and compliance scrutiny threaten to expose business leaders who are only assessing gross and net sales independently or at the aggregate level, rather than the correlation between and the underlying variations. Taking it a step further, G2N must become a full-fledged corporate strategy for determining viability by product, by market: ultimately, the conscious choice of investment into G2N should be with stakeholder behaviors in mind – rewarding and incentivizing value chain players
to deliver against strategic objectives of the Life Sciences company. A top-down and bottom-up program.

Still not convinced? The proof is in the pudding…

Selected KPMG Life Sciences G2N case studies

Optimized the value chain for an off-patent pharmaceutical, reallocating supply across targeted markets

▼

Results = US$40 million savings identified

G2N transformation of an entire oncology portfolio into a more sustainable business model

▼

Results = US$40 million savings identified

Deep data analysis for a Life Sciences company of profitability by SKU, customer, and channel

▼

Results = US$45 million savings identified

New G2N and pricing strategy for a pharmaceutical distributor, including setting of G2N KPIs

▼

Results = 10% profit uplift, with more than US$6 million delivered in the first 12 months

The G2N journey is a purposeful, step-wise approach

Now that you better understand the "what" behind G2N, let's dig into the "why". G2N optimization is not simply a matter of auditing and monitoring compliance to a policy, or removing discounts. It is about ensuring that all investments into G2N are able to support and deliver on the ambitions of the company.

In an ideal world, all investment into G2N, be that via rebating, discounts, offering free-of-charge goods, patient programs, etc., should be *effective* – focused on incentivizing a chosen customer behavior or outcome, typically growth or maintenance of sales. In order to be effective, that customer behavior must be articulated in an actively-managed and implemented commercial policy, and bounded by *conditionality*. The customer must be seen to achieve the targeted behaviors in order to earn the G2N investment. To be able to monitor and test the conditionality of the G2N investment, data must be *accurate* and *transparent* – gathered together in one place, allowing cross-portfolio, cross-channel, and cross-customer comparisons to be made, and checking that G2N investment is *defensible* – each commercial decision held to account for the customer behavior it is seeking to bring about.

KPMG in Singapore's Theory of G2N

Common Issue	Gross-to-Net Focus Areas
TRANSPARENCY: No 'one version of the truth' set of G2N data, masking true levels of discounting.	CONSOLIDATE AND VISUALIZE: Bring data relating to all customers, products and teams together to ensure transparency.
ACCURACY: Lack of consistency/accuracy in managing discounts and rebates, making comparisons difficult.	CORRECT: Gross and Net price inconsistencies across invoices are corrected so that discounts are now appropriately applied.
DEFENSIBILITY: High levels of (unjustified) price variation across customers, leading to under-performance and risk.	REDUCE: Over-use of commercial discount and re-focus on larger customers/defensible accounts. Reduce discount for "long-tail" customers and products.
CONDITIONALITY: Lack of (actively managed) conditionality of discounts and rebates	ELIMINATE: Discounts or rebates for customers that do not meet qualifying criteria; e.g. customers did not meet volume targets
EFFECTIVENESS: Discounts, rebate and trade terms do not drive desired customers behaviors or financial outcomes.	RE-ALIGN: Discounting and rebating policy to desired customer behaviors and combine with compelling propositions to grow share of wallet with target customers.

Data transparency and accuracy are the cornerstones of G2N management: without these, it is impossible to measure, govern, and control G2N investment. As an example, we frequently find that in a single market or channel, different customers are being offered different gross, or list, prices for the same product – which means that some are receiving an unmonitored, unplanned discount thereby representing lost value to the Life Sciences company. This challenge is especially acute when international list prices are maintained to manage price referencing, but there is a need to meet affordability requirements within a market; in other words, there is no one real, true list price for each product. It may seem basic, but it happens! And without the right tools and data to monitor the G2N situation, it goes under-detected.

You've got the data... or do you?

Accuracy

- **A** Sales, volumes, and discounts are attributed to the wrong part of the value chain (e.g. distributor rather than customer)
- **B** Mis-recording of patient program free-of-charge goods, investments under discounting
- **C** Mis-recording of discounting investments under patient programs and vice versa (patient programs recorded in discount categories)
- **D** Different list and net prices appear on invoices for the same product, to the same organization
- **E** Gross price does not reflect list price
- **F** Different types of price reduction – e.g. government-mandated price cuts and discretionary discounts – are recorded in the same place and thus indistinguishable
- **G** No attribution of discounting investment to the specific policy which gave rise to it (especially when multiple policies are active)
- **H** Multiple codes for same customers names and/or multiple customer names for same code
- **I** Addition of statistical quantities when posting discounting activities in SAP which need to be filtered out from the data

Transparency

- **A** Sales, volumes, and discounts are not tagged to the end customer to whom the discounts are paid
- **B** Where discounts are based at a group level, some branches / subsidiaries of a given entity are not linked to the group to which they belong, making tracking of the discounts they receive challenging
- **C** Different customers receive different list prices – meaning some have greater effective discounts than others
- **D** Different data sets pertaining to the same activity – or which relate to each other – share no common identifier key and often have misaligned time periods, causing difficulties in integration
- **E** Different incentive-based schemes (e.g. patient programs, affordability programs) are recorded together and thus indistinguishable
- **F** SAP / data source customization as a root cause of transparency issues e.g., needing to manually apply filters on data to derive G2N categories

In addition to the above, a challenge that Life Sciences companies will quickly learn as it pertains to G2N is that the number of potential scenarios and dimensions is actually exponential. Compounding influences come from a range of angles, including regulation, contracts, product launches and LOEs, access, competition, and parallel trade. Therefore attempting to do this by hand or even with basic tools will render less-than-satisfactory results. Of course, as with any organizational change, G2N is not just about tools and technology either. Ultimately the success of a G2N program lies within the definition of a focused, targeted strategy, the execution of that by its people, and the suitable governance and monitoring to ensure that the execution delivers the targeted results. This requires a best-in-class approach.

G2N best practices checklist: a 30-week journey to stabilize, with a never-ending commitment to perfection

1 Sizing up the problem (14 weeks)

The objectives of Step 1 are to gain a clearer view of the G2N data, to build the supply allocation model by market, and to generate the list of hypotheses. Specific activities of Step 1 include:

- Gather granular data, enabling analysis of G2N at a level in which commercial agreements are made (typically end customer)
- Analyze the data, commercial activities, and policies by product, market, channel, and customer (in a non-linear fashion) to bring G2N leakage to light in a visual, accessible manner
- Overlay market context addressing external influences such as competitor and channel dynamics, utilizing benchmarks only if available at a suitably granular level
- Leverage cross-functional teams to be creative about the potential causes and solutions for G2N leakage

2 Validating and sequencing the theory (4 weeks)

The objectives of Step 2 are to uncover the constraints of the identified hypotheses, and to short-list the high-probability ones through sequencing them by market. Specific activities of Step 2 include:

- Prioritize the hypotheses based on where the maximum impact and quick-wins are sitting
- Gain top-down and bottom-up approval of the refined list, including updates to the modelling

3 Embedding a G2N culture into the organization (12 weeks)

The objectives of Step 3 are to establish the in-market champions for the waves of G2N testing, to outline the change management approach, and to adopt strong governance. Specific activities of Step 3 include:

- Engage local market teams in the final design of G2N models, including G2N scenarios, supply allocation, and benefits
- Create country- and customer-specific implementation plans, which can also be used as a progress tracking tool
- Concurrently, create an above-market playbook for training, governance, and KPIs for the G2N program

4 Sustaining the new way of working (ongoing)

The objectives of Step 4 are to align baselines and benefits tracking, to intervene where performances are lower than expected, and to enact G2N as a go-forward tool for pricing, commercial, and finance teams. Specific activities of Step 4 include:

- Establish internal ownership and championing of active G2N management
- Instigate a mechanism to evaluate financial and cultural assessment of G2N country teams
- Quickly identify performance gaps, understand the root causes, and pivot with mitigation plans
- Consolidate G2N results with traditional pricing – see how G2N can influence pricing going forward

Life Sciences companies are also advised to think carefully about tax implications of changes to G2N strategy, especially when reallocating profits and under greater scrutiny from BEPS regulators. Structuring, value chain, IP, transfer pricing, incentives, property, and capital allowances should all be taken into account. Hence the importance of establishing a multidisciplinary G2N project team from the get-go.

Underlying all of the above is the interaction between global, regional, and country teams. Collaborative workshops, regular engagement tactics, and building new capabilities are excellent enablers for success. Indeed, a Life Sciences company's culture of accountability and empowerment are critical to getting everyone moving in the same direction.

Unleash the mouse that hunts - G2N is not just a strategy, it is a must-have leadership capability

There are already a number of case studies and best practices to leverage as it pertains to adopting a G2N strategy for Life Sciences operations in the Asia-Pacific. But one gap remains – the "enablement".

At KPMG in Singapore, our experience has led us to understand that true G2N excellence requires a digital solution capable of processing an infinite number of attributes and dimensions at the granular, customer level. Such a solution ensures that there are minimized human errors in calculations, and that we don't create artificial limitations on the internal and external inputs required when designing the G2N strategy.

Although many Life Sciences companies hold the necessary data through years of ERP standardization and other business intelligence tools, often the pieces are not of the same design and format and are thus not easily integrated, or else are not sitting in one central place that facilitates inherent G2N analysis, or perhaps even not easily accessible at the right level of granularity. For example, SKU level detail may be available, but by SKU by customer? These two dimensions alone require data about pricing floors, compliance, channels, purchasing rebates, right down to the invoice level. Access to the right data can also be complicated further when a Life Sciences company is operating in a market via a distributor arrangement and hence lacks access to the full value chain data. Now consider the other various dimensions associated with market-based activities such as reimbursement, ABAC, key accounts, local portfolio nuances. You get the picture. And whatever G2N solution is put in place should enable long-term scalability and shifting commercial policies. Gathering the right data a single time is one challenge; it is yet another to ensure the data is refreshed and updated to enable continuous and ongoing proactive G2N monitoring and management.

At KPMG in Singapore, we refer to such enablement as "the mouse" – a Gartner Magic Quadrant capability that, when pointed in the right direction through smartly-defined G2N theory, can sniff out the details through automated, algorithmic data mining. The more granular, the better.

The "mouse" has two distinct skillsets:

- Ability to extract desired data attributes from segregated source systems (within company policy, of course)
- Multi-dimensional, mathematical value assessments using scenario and sensitivity testing models

Negotiable Discounts & Rebates	Direct to Customer
	3rd Party
Non-Negotiable Discounts & Rebates	Direct to Customer
	3rd Party

Patient Programs

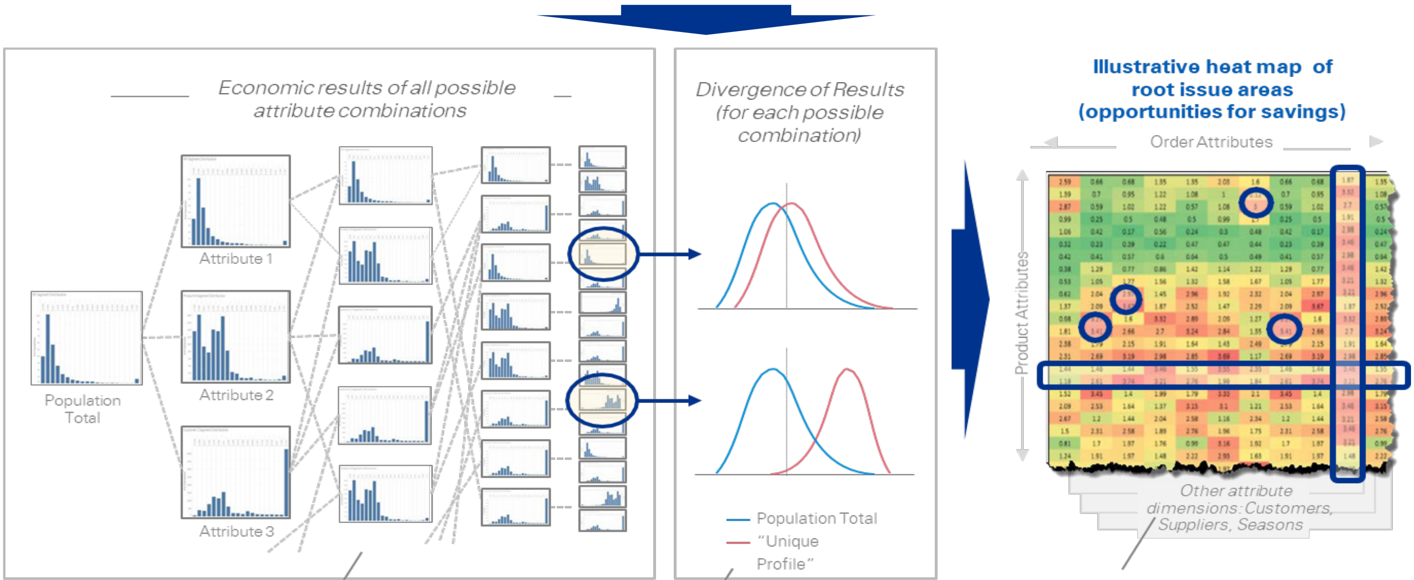
Early Payment Cash Discount

Distribution Service Allowance

Pricing Controls

Clawbacks

Tax



(1) Our algorithms can examine the performance of every possible attribute combination with domain-specific features…

(2) …combining machine-learning outlier detection with advanced data consolidation…

(3) …resulting in priorities for human attention by quickly finding important behavior in data.

No matter the target set (0-5% G2N reduction, 5-10%, etc.), a Life Sciences company is able to refinance itself almost immediately. Whether this be aligning to commercial policy or covering other margin costs like logistics, a G2N investment strategy is a core capability for the Asia-Pacific. Here are four lessons we've learned through our own experience thus far:

1. Assign a designated G2N Lead of senior credibility, who is able to collaborate cross-functionally above market as well as inspiring the local teams so as to drive effective change management
2. Align global, regional, and local teams through creation of a consolidated data set that represents the "single source of truth" which can underpin decision-making around G2N investment at all levels
3. Treat G2N seriously by making evidence-based decisions about strategy and implementation, including being realistic about push vs pull products and market segmentation (read our prior segmentation article here)
4. Innovative ideas about G2N causes and potential solutions require creativity, so be sure to leverage a multidisciplinary functional team profile (pricing, commercial, supply chain, tax, human resources, modelling, IT, compliance)

We hope the message is clear – don't mistake top-line growth for a viable business strategy, and beware of what may lurk beneath. As is often said, there are two stages to transformation: to start, and to keep going. Let's work together to build robust G2N programs for the Life Sciences industry in the Asia-Pacific, and beyond.

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