Will Big Pharma Heed the Call to Bring Jobs Home?

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Introduction

President Trump's emphasis on putting America first and returning manufacturing jobs to the United States has clearly signaled that no industry is safe from his scrutiny and vitriolic criticism.

Regardless of one's personal beliefs about the polarizing administration, there are solid moral and economic reasons the President placed a large target on the pharmaceutical industry's back. The United States is an important market for major pharmaceutical companies, as its consumers pay the highest per capita drug prices in the world and account for the plurality of their revenues **[Exhibit 1]**.

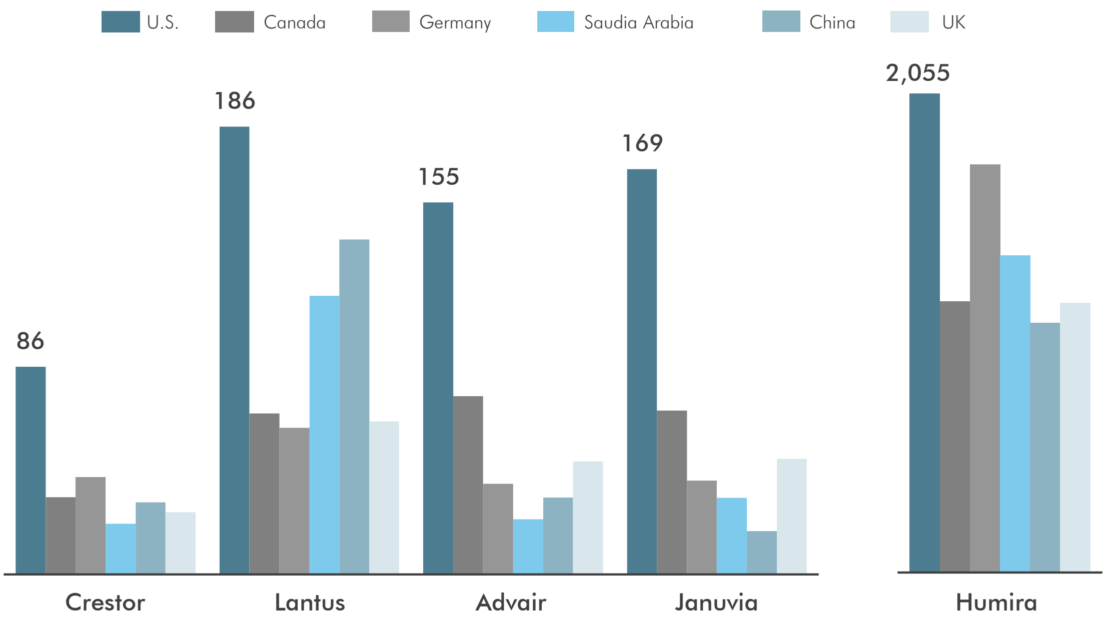
EXHIBIT 1

Drug price comparison of multiple countries

Source: Bloomberg

Comparison of U.S. vs. non-U.S. drug prices, 2015

US$ price per month with discount; by drug, by geography



Yet, the percentage of workers the industry employs in the United States equates to only a fraction of the revenue reaped in the country. **[Exhibit 2.]** Analysis of the data behind Exhibit 2 makes it undeniably clear that while Big Pharma derives a substantial chunk of its revenue from the United States, most of the jobs it creates are located in other countries.

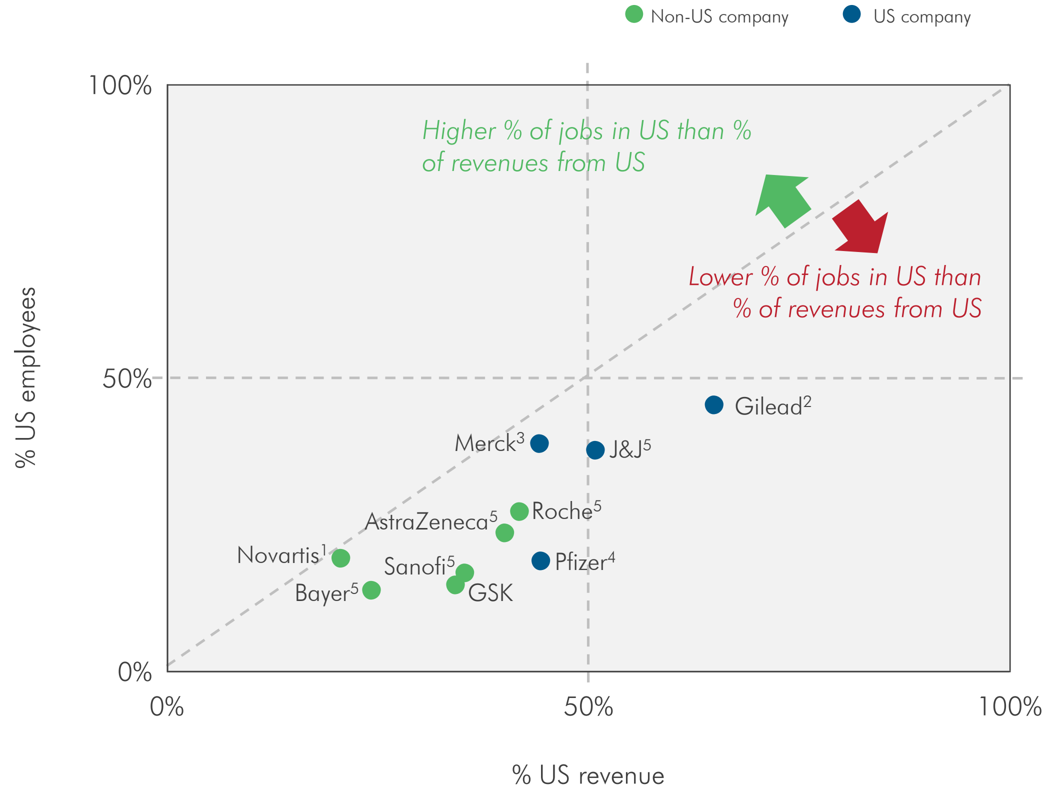
Against this backdrop, the mandate to bring drug prices down, do it quickly, and bring manufacturing jobs back to the United States is understandable and long overdue.

EXHIBIT 2

U.S. employment and revenue characteristics

Source: 2015 annual reports, 10-Ks, and/or 20-Fs for the mentioned companies

Top 10 Pharmaceutical company's % U.S. revenue vs. % U.S. employees, 2015; Percent of total



Potential U.S. Regulatory and Policy Levers

To add fuel to the fire, the Trump administration has at its disposal an arsenal of regulations and policies that could force pharmaceutical companies to comply in lowering drug prices and re-shoring jobs. If enacted, each of these actions would directly affect Big Pharma's core business in the United States and potentially cause serious headwinds to their top lines.

Potential actions:

- Patent reform
- "Made in the U.S.A." requirements
- Price caps or maximum price formulas (similar to medical loss ratios)
- Nationalization of key drug patents
- Consumer advertisement bans
- Anti-trust breakups

1 US revenues for the Pharma division only; Non-US revenue includes other applicable divisions, as no geographic location was specified
2 US employment estimated based on data in their 2015 CSR report
3 US employment includes Puerto Rico
4 Only includes "Pfizer employees;" Does not include "additional jobs supported"
5 US employment is using the number for North America

On the other hand, the new administration can use these same levers to make it easier for the pharmaceutical industry to do business in the United States, in turn potentially enabling significant improvement to Big Pharma's revenues and bottom lines.

Potential benefits:

- Shorter FDA drug approval process
- Tax benefits for companies shifting jobs onshore
- Patent evergreening
- Potential influence on patent laws in developing countries such as Brazil, China, and India

Repatriating Jobs

One sure way to generate positive reactions from the Trump administration is to proactively employ more U.S. workers by repatriating previously offshored jobs. Doing so would clearly signal Big Pharma's commitment to making American workers a major component of their global workforce.

At a high level, manufacturing, R&D, and services jobs are typically outsourced in the pharmaceutical industry.

Although President Trump is keen to bring manufacturing jobs back to the United States, moving an entire FDA-compliant production factory and establishing the associated supply chain and logistics would be a complex, Herculean, and risky effort. Theoretically, doing so is entirely possible. But practically, new U.S. jobs would not appear in significant numbers for two to three years, which is too long for the Trump administration.

The services category, however, is a much more reasonable alternative for repatriating jobs. Services jobs, such as those that involve pharmaceutical industry-specific support processes, IT, contact center, finance and accounting, and human resources, pose far less risk, as they have no disruptive impact on Big Pharma's core manufacturing and distribution operations. Additionally, services jobs are primarily labor-based, and many are already centralized offshore, allowing for a quicker transition to U.S. onshore locations.

While, as **Exhibit 3** shows, the number of offshored manufacturing and R&D jobs dwarfs the volume of services jobs offshored, repatriating up to 140,000 services jobs could go a long way in appeasing the Trump administration and earning its good will.

Of note, approximately 65% of offshored services jobs in the pharmaceutical industry are located in India.

EXHIBIT 3

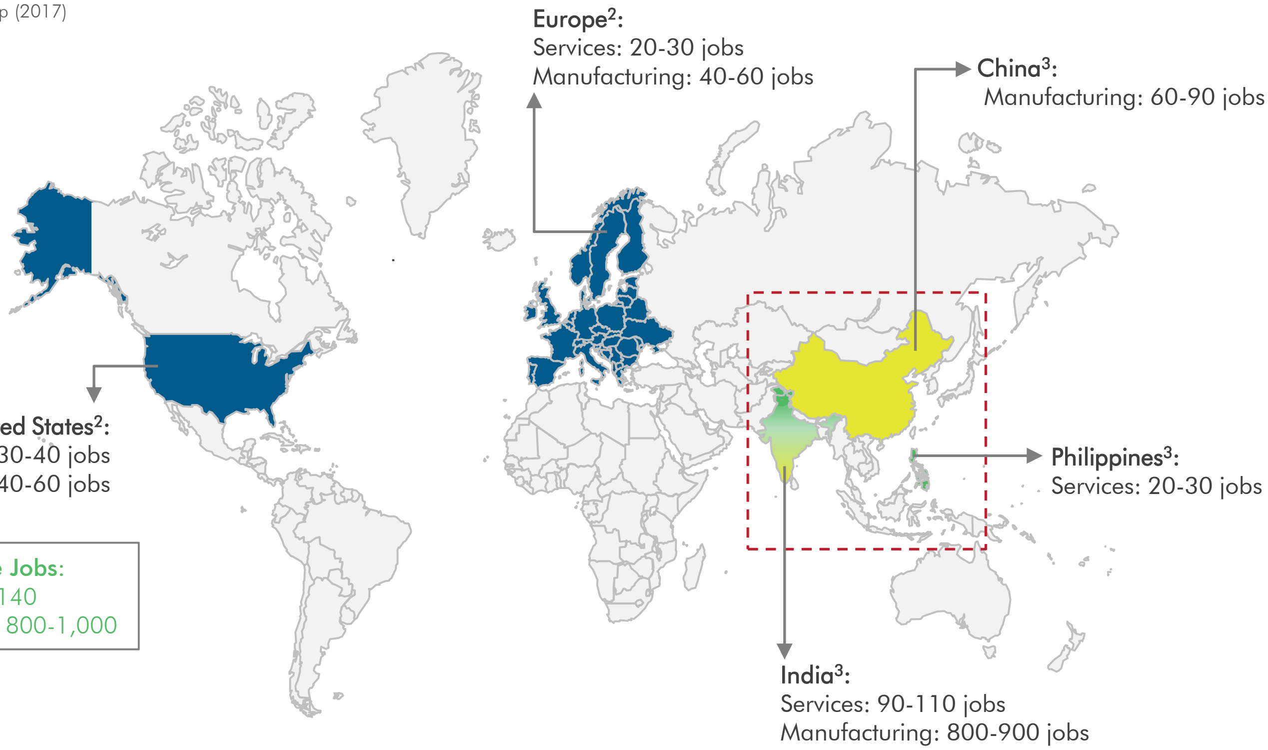
Outsourced pharmaceutical jobs landscape

Source: Everest Group (2017)

Key locations for offshored and outsourced pharmaceutical jobs

Third-party and GICs[1]; in thousands

Onshore jobs | Offshore services jobs | Offshore manufacturing and R&D jobs



Total Offshore Jobs:
Services: 110-140
Manufacturing: 800-1,000

Major Concerns Associated with Onshoring Services Jobs

Of course, there are certain challenges associated with moving jobs onshore, including:

- Cost
- Managing existing vendor relationships
- Finding the right talent supply within U.S. borders
- Establishing sufficient scale in U.S. delivery centers to run operations

The pharmaceutical industry's services jobs did not end up in India by chance. They were offshored there deliberately in order to take advantage of labor arbitrage and the large educated workforce.

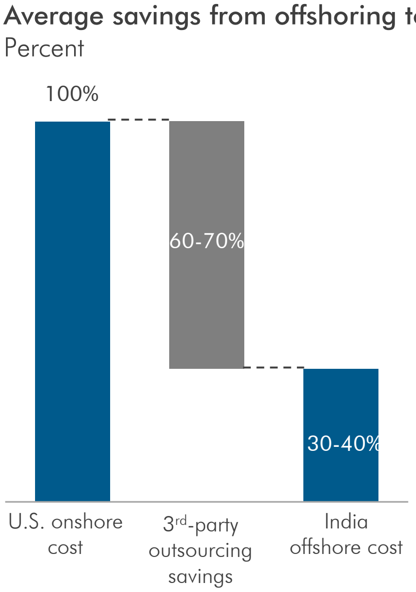
The cost differential between Indian labor rates and those in U.S. onshore locations is 55-70%. **[Exhibit 4]**.

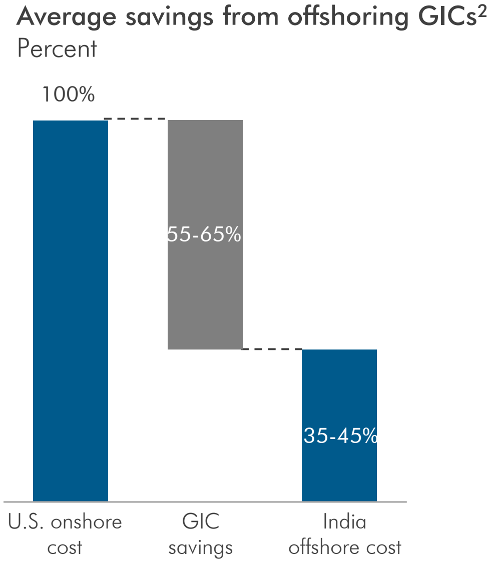
1 Global In-House Centers (GICs) are offshore service delivery centers staffed by company employees
2 Outsourced, onshore United States and Europe services jobs predominately support in-country or in-region operations
3 Services jobs in China, India and the Philippines are offshored jobs from other countries and, to a lesser extent outsourced from within India and from APAC countries

EXHIBIT 4

Cost savings realized from offshoring

Source: Everest Group Global Benchmarking Studies (2016)





As a result of this substantial price difference, Big Pharma will need to be careful to mitigate the increased cost impact. A reasonable objective for Big Pharma is to make any repatriation economically neutral. One thoughtful approach is to utilize digital service delivery models.

Leveraging Digital for Mitigation

Digital capabilities, such as cloud, automation, and advanced analytics, have the ability to help Big Pharma transform how their services (e.g., A/P, benefits administration, application development, and customer service) are delivered and simultaneously open the door to operational savings by decreasing the associated labor costs. As shown in **Exhibit 5**, digital levers can achieve significant savings over traditional service delivery models, depending on the process and technology applied.

EXHIBIT 5

Potential savings from digital transformations
Percentage

Source: Everest Group (2017)

Digital levers	Cost savings[3]
Cloud	20% - 40%
Smart/Cognitive Automation	30% - 60%
Robotic Process Automation (RPA)	20% - 35%
Predictive, Prescriptive Analytics	20% - 35%

1 Excludes R&D and manufacturing (only includes services)
2 GICs are a company's foreign operations that are established to utilize talent in offshore locations; typically not as efficient as 3rd-party service providers
3 Savings estimates based on US onshore locations

"Johnson & Johnson has set a target of 2018 for having 85% of apps in the cloud "

– Wall Street Journal, July 1, 2016

"Cloud-centered IT transformation and insourcing helped reduce AstraZeneca IT spend by half"

– Forbes, October 20, 2016

When implemented in tandem with repatriating jobs, digital could help Big Pharma reduce their dependency on manual labor. While on a per-FTE basis the arbitrage will continue to exist, reducing the scale required would minimize the total cost of service delivery.

But the importance of digital technologies extends far beyond cost savings. Enterprises are increasingly looking to their outsourcing partners to also quickly transform how they deliver their services.

Although digital transformation of services would preclude Big Pharma from bringing all offshored jobs back onshore, it would create higher-paying, higher-skilled, and highly productive U.S. services jobs. And, in tangible numbers that can appease the current presidential administration.

Conclusion

Pharmaceutical companies face no shortage of uncertainty around the Trump administration's next steps for the industry, and we expect this challenge to increase after the American Healthcare Act fiasco. But one thing is certain: Big Pharma needs to take action now with focused efforts to repatriate services jobs to mollify the geo-political headwinds in the United States.

Their first step should be to proactively assess talent management and shared services strategies in order to find out what is possible in the short- and near-term. Conversations need to begin among service delivery heads, as well as with service provider partners, in order to explore solution options, ensure alignment, and capture the sense of urgency.

Meanwhile, service providers should augment their digital technology and onshore capabilities now, instead of adopting a wait and watch strategy. Doing so will help them stay ahead of the curve and add value to their clients, even potentially becoming a life saver for their Big Phama clients. Indeed, it may keep them from losing clients in numerous industries altogether.

Everest Group's watchword in this volatile environment is "now": Act now to spare your company from an angst-provoking, and potentially damaging, Tweet.

About Everest Group

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