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Early Warnings

Business tsunamis are approaching. Learn how to prepare.

BY LEONARD FULD

How well is the pharma industry prepared for rapidly approaching industry upheavals? Not very, according to a 2002 global survey on corporate early warning systems conducted by the Fuld-Gilad-Herring Academy of Competitive Intelligence. More than 100 managers responded, most of whom work in their companies' strategy, product management, or intelligence departments.

Although 77 percent say their companies anticipate an increased level of business risk in the next two or three years, only 2.6 percent claim to have a formal early warning process in place. The majority (56.4 percent), say their companies have only some components in place, and more than 37 percent report they have no systematic process.

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The survey, modest as it is, exposes a large gap in competitive preparedness. Nearly every manager sees one or more looming threats just over the horizon, yet only a small fraction have done anything to see around the corner. This article describes how pharma companies can implement an early warning system that will help them prepare for the future, no matter how it unfolds.

Collective Upheavals

Despite deal making and some farsighted alliances and acquisitions, the industry has collectively neglected to anticipate a number of significant shocks that have begun to erode its potency and future earning potential. Pharma companies involved in producing AIDS drugs did not anticipate the moral backlash and media frenzy surrounding the provision of low-cost drugs to Africa. Back in the early 1990s, many pharmaceutical companies did not believe that price controls were imminent in the United States. They saw Hillary Clinton's failed attempt to rein in the

healthcare and pharmaceutical industries and breathed a sigh of relief. Nevertheless, price controls became a norm in Western Europe and Canada and are now one of the US public's biggest concerns. Even if Congress hears some of Big Pharma's arguments, chief of which is that price controls will choke cash needed for R&D investment, one outcome is definite: Change will occur. The decades-long US pricing policy status quo is about to come to an end.

Company Blindness

At the company level, competitive blindness is the biggest reason managers fail to prepare for dramatic change. The blindness is mostly self-induced. That is, managers are often unable to see the long-term threat or opportunity because of the way they categorize it in their minds. An example of that competitive blindness expressed itself during a consultation with a US-based biotech.

This particular company has had a successful run with two of its treatments but is now encountering competition for the first time. Suddenly, it is dealing with problems such as me-too products on the market, alternative treatments, generics, and pricing pressure from managed care insurers.

When the product managers and marketers were asked, "How do you know when you need to learn about long-term threats (or opportunities) or what those threats might be?" they weren't sure. So they were asked to examine and rate only two factors:

- » the impact a particular set of events might have on their company and its bottom line
- » how certain they were that the event would happen in the first place.

They were given a list of six events that might occur over the next few years and asked to apply the two criteria. Following are three of the scenarios and how they rated the impact and certainty of those events.

- » Generic forms of their leading drug will enter the market within one year after their patent expires: complete certainty and extremely high impact.
- » Technology development, new delivery technology, genomic lead discovery, and continued small-molecule development will replace the need for their biotech solutions within 10 years: very uncertain but high impact.
- » Medicare reimbursements for one of their key products will drop precipitously over the next few years: highly certain and also high impact.

Tsunamis in Other Industries

Every industry has upheavals that change how companies conduct business. These shocks can even eliminate some companies altogether. Many managers can see danger years ahead of time, but few act on these future visions. Here are several of the most currently prominent:



Telecommunications: Wireless applications threaten the landline telecommunications revenue stream.



Big Software: Microsoft and Oracle fear the onslaught of open software and Linux; Sun has chosen to embrace it.



Petroleum: This industry sees fuel cells and alternative energy sources on the horizon.



Photography: Consumer digital photography, forecast to hit \$12 billion in sales by 2007, is a market that companies such as Kodak and Polaroid essentially missed.

They quickly realized that they were dealing with two very different sets of problems. When an issue has both high impact and high certainty, it means the problem or the opportunity is already here and needs to be dealt with. It is a tactical issue that needs to be tracked with all of the company's resources—databases, heard-on-the-street information from salespeople, news sources, etc. Price controls are one prominent example of a "high impact, high certainty, here now" problem.

When a coming event has high impact on the business but a great deal of uncertainty surrounding it, then it is a true long-term threat or opportunity and is a prime candidate for early warning. Genomics, for example, hits this mark. Its role in drug discovery and development has the potential to affect the entire pharma food chain. Yet, the uncertainty of where and when genomics will have that impact makes it a perfect topic for early warning.

What makes an early warning process valuable is its ability to help a company avoid driving itself toward one specific outcome, which increases its chances of being wrong. That's risk. Taking the time to sketch three or four outcomes—and plan strategies that account for each outcome—gives companies a safety net.

Control Your Destiny

How will pharma executives deal with major upheavals when they arrive? Based on other industries that have recently experienced

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tsunamis, the answer is that some companies will thrive on the changes, while others will end up fighting for survival. Unfortunately, there are many examples of pharma firms waking up too late to do anything but to try to plug the dike.

The biotech tsunami—now over 20 years in its formation—has caught a number of traditional pharmas by surprise. Pfizer is one example. By the late '90s, the company's pipeline had thinned, and Pfizer needed to fill it—at any cost. Instead of recognizing the potentially long-term but less expensive biotech approach to developing future blockbusters, the company ignored the tsunami and found itself up against a wall. So it paid dearly to acquire the blockbuster Lipitor (atorvastatin).

Another example is the HIV tsunami, which took a bite out of GlaxoSmithKline and others in recent years. Following Glaxo's Zantac blockbuster of the '80s and '90s, the company saw the HIV market as a potentially explosive opportunity. What it and others did not anticipate was the backlash from countries in Africa where AIDS had reached epidemic proportions and for whom the high-priced drugs were out of reach. Political pressures from the United Nations and from other groups have forced companies to deliver HIV-fighting medica-

tions at or below cost. A once promising blockbuster opportunity disappeared. Again, the AIDS tsunami did not suddenly emerge; it was more than a decade in the making.

The war game difference. A few years ago, a large European-based pharmaceutical company that faced a competitive shock decided to run a war game. Its blockbuster's patent would expire within the next 24 months, and having lived off the product for so long, the company kept trying to find ways of extending its lifecycle through various formulations and patent-extending approaches.

Management began the exercise with the belief that they should acquire a new pipeline with the cash hoard from the blockbuster product. They ended the exercise with a realization that the future would not be theirs to control. Even when the management split into two isolated groups, the two teams independently came to the same general conclusion: A Big

Pharma would either detour around them by buying or developing the new products the company wanted to develop or would simply acquire the company directly.

Although the war game did reveal some intriguing alternatives, it failed to provide management with the desperately sought miracle cure to its pipeline woes. War games are not early warning systems, as many executives have thought. War games are a useful way to adjust the company's strategy when it has already prepared for the future and has resources in place for acting on that future.

Early warning drivers. These are the building blocks companies should use to paint different scenario images. Drivers prescribe the future world because they define the rules of that world and how companies, societies, and people behave. Drivers can emanate from technology, government regulation, shifts in the economy, or shifts in competitive power as would occur through mergers or increased buying power of a particular customer, such as a Medicare program or a giant managed care program.

Like billiard balls ricocheting around a table, how these drivers interact can shape the scenario and change the outcome. For example, if a driver is "Government will enact stricter price controls," the result could be to create a scenario of a new world of giant managed care. Another scenario would be a world of "shriveled pharma," whose financially starved R&D operations radically tip the balance of power in the industry away from brand-name companies and to generics or biogenerics.

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The Toolkit

Companies as diverse as Visa International and AstraZeneca have greatly benefited from an early warning process. The common bond among those companies' programs is the consistency and the discipline their managers have applied all along.

The tools are simple: scenario analysis, constant information collection and analysis, and, finally, an effective means to expedite decisions—when you see the wave approaching. Although the payoff can be enormous, management needs to have the same type of patience it does in bringing a decade-long developmental drug to market. Early warning is a process, not a quick fix.

Scenario analysis is an art that many companies have adopted. Executives generally enjoy such exercises. Unfortunately, once the storytelling has ended, often so does the discipline. That is, most companies fail to connect the future road maps they created through scenarios with a process to track those potential futures. The road maps gather dust—and surprises



IN A RECENT SURVEY BY THE FULD-GILAD-HERRING ACADEMY OF COMPETITIVE

Intelligence, fewer than 3 percent of all respondents say their company has a formal early warning system to anticipate competitive threats looming on the horizon. Respondents also say that a great deal of evidence supports their belief that their companies will experience future competitive shocks. The survey data show that top management is failing to implement, or recognize the need for, early warning capabilities.

Past evidence of competitive shocks. Respondents claim a high incidence of market and competitive surprises. When asked, "How many times in the past five years has your company been surprised by events that had the potential for a significant impact on your long-term market position?" only 6.5 percent say, "Never." The majority (67.6 percent) say their organizations encountered as many as three high-impact events in the past five years, and 25.9 percent report more than three events.

Poor handling of bad news. According to survey participants, management reacts slowly or inconsistently when a threat arises. Nearly half say that management's attitude toward hearing bad news ranges from "says he knows it already and does nothing" (28.2 percent), to "deny it as poorly thought out or presented" (13.3 percent), to "does not want to know and will potentially punish the messenger" (4.8 percent). Although nearly one-third (30.3 percent) believe their management encourages debate about the news, they suggest that decisions do not result from the debate. Only 23.4 percent actually encourage fast delivery and distribution of the news.

Slow response and "black hole." Even after management has identified an early warning shock ahead of time, respondents are not confident in its ability to respond in a timely manner. Only 7.1 percent believe management is proactive, and only 13.3 percent have a method of "forcing quick action" in their company. The remaining respondents see "paralysis by analysis" (17.6 percent), a slow but late reaction on the part of management (34.8 percent), issues disappearing into a "black hole" (16.7 percent), or management that will only discuss the potential shock with outside consultants (10.5 percent).

The full survey results are available in the report "Early Warning: Management Need...Management Failure" at www.fuld.com.

and shocks inevitably arrive.

Visa International. This company did connect the dots. It also followed through by running a process to track the stories. The one that concerned it most during 2000 was the potential invasion of peer-to-peer (P2P) internet alternative payment systems, which promised to make paying on the web and elsewhere very easy. At the same time, these systems threatened to marginalize the traditional credit card players, Visa and MasterCard among them.

Visa's intelligence organization not only developed the scenarios, it also identified signals necessary to track which road maps would emerge. The result: comfort intelligence. The signals included P2P's level of advertising expenditures, their ability to sign up (and sign away) merchants, and even the level of capital that venture funds were investing in these start-ups. Quarter after quarter, the intelligence team tracked the markers. By early 2001, the scenario that emerged was far less threatening. Monitoring and reporting on the evolving nature of the potential threat also gave Visa management time to roll out a reasoned strategy that would both strengthen its market position and retain its customer base.

AstraZeneca. Three years ago, this company's strategy and intelligence organizations began to build a similar early warning process. But the US commercial organization has taken the concepts the furthest and the fastest compared with other areas within the business. "Our commercial group has experienced some very dramatic changes in the US business as a result of the early warning work we've done," says Wayne Rosenkrans, intelligence affairs director at AstraZeneca. "Money and people have

next market opportunity, or—even better—create a more profitable market. ④

Are You Ready?

To determine your company's early warning status, answer this survey question. (The lower the number, the better):

Which of the following describes your approach to analysis of competitors' future moves?

- 1 My company has a systematic analytical process for predicting competitive shifts.
- 2 We informally discuss competitors' plans, mostly within sales and marketing meetings.
- 3 We try to anticipate competitors' strategic moves in our annual planning meeting(s), but have no specific, consistent methodology for it.
- 4 Competitors are not considered a strategic threat, and we have no regular discussions of their intentions or capabilities.
- 5 We know very little about our competitors' long-term plans.

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been moved around." Rosenkrans says that strategy creation and early warning processes are linked, and he breaks them down into six steps:

- » Set objectives.
- » Identify key drivers.
- » Build scenarios (road maps).
- » Determine strategic implications.
- » Adjust company strategy.
- » Update findings (early warning).

At the start, the AstraZeneca team spent a great deal of time determining the drivers and preparing the foundation for each potential scenario. Team members interviewed panels of internal and external experts to elicit those drivers, test, and ultimately prioritize them.

The drivers were used to create a series of future storyboards, which in turn had to be distilled into a small set of plausible, if not probable, scenarios that delineated the possible boundaries of the future. Those scenarios then became a "toolkit" for the management team to use in creation of its business strategies. For the early warning process to be effective, the team must also understand how the driver set will evolve and how that evolution will affect both the scenarios and associated strategies. Looking back at the three-year odyssey of AstraZeneca's process, Rosenkrans recalls that the first round, including interactions with management, took an entire year.

Bottom-Line Benefits

If a year seems like a long time frame, keep in mind that early warning will help a company take advantage of a multibillion-dollar opportunity or avoid an equally gargantuan mistake. As a result of such systems, Shell predicted the drop in the value of crude oil, Fuji established a competitive leg-up on Kodak in a consumer digital-camera market that is forecast to be worth nearly \$12 billion by 2007, and Visa avoided making costly jump-too-soon mistakes by prematurely acting on the P2P threat.

Big Pharma has a lot of expensive chips on the table. Early warning can help companies shelter those investments from the next tsunami, find ways to ride the wave to the

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