How life sciences CFOs can drive a reimagined capital strategy

Global capital allocation report 2021

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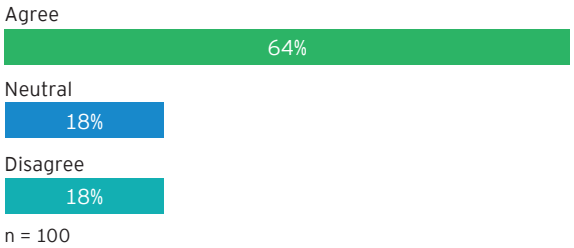
Post-pandemic, the majority of life sciences CFOs say their capital allocation strategy needs to be rethought

Life sciences companies' abilities to invest capital fared better than those in other sectors during the COVID-19 pandemic, but that hasn't stopped the majority of industry CFOs from saying how they need to re-examine their strategic approach to capital allocation.

CFOs can help improve the capital allocation strategy and process by understanding how long-term strategy may be changing, especially in light of the COVID-19 pandemic; choosing KPIs that reflect both quantitative and qualitative long-term strategic goals; and establishing governance to drive consistent decision-making to support long-term value creation.

Almost two-thirds (64%) of the 100 life sciences CFOs surveyed in the first weeks of 2021 say that their capital allocation strategy needs to be completely rethought. That compares with 56% of the 1,050 CFOs surveyed across industries. The pandemic may have permanently shifted some of the long-term strategic needs for life sciences companies, which may account for the difference.

Q **We had to completely rethink our capital allocation strategy and process.**



77%

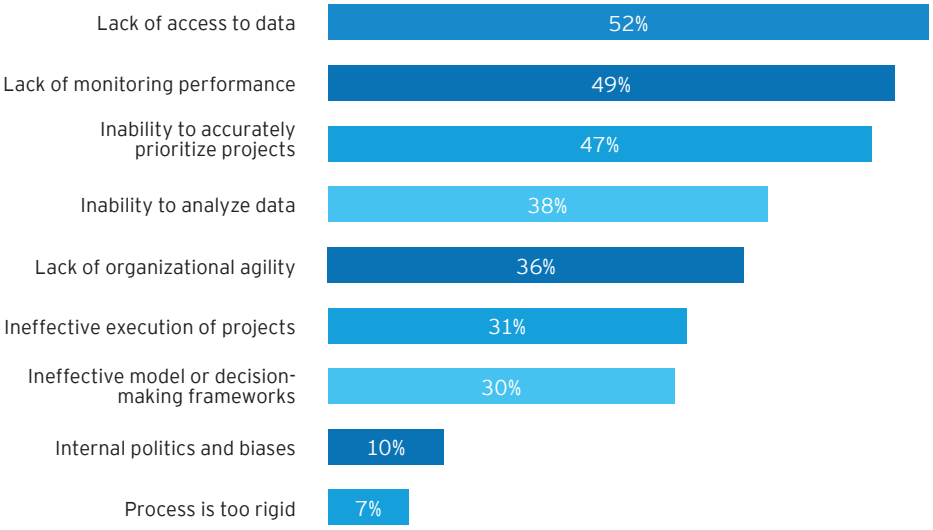
of life sciences CFOs say their capital allocation process is only somewhat or not very successful.

The disruption of global supply chains, the consideration to near- or reshore manufacturing, building strategic stockpiles of certain drugs and securing active pharmaceutical ingredients (APIs) could lead life sciences companies to redirect some investment to domestic manufacturing. At the same time, the successful use of mRNA technology in developing COVID-19 vaccines may prompt more companies to invest in the technology, either through their own R&D, acquisitions or partnerships. Additionally, the need to develop more digital platforms and tools to improve patient outcomes is a growing area of focus.

In some ways, life sciences companies may be in better shape to revamp their capital allocation strategy and processes: only 34% say the pandemic had a negative effect on their capital allocation investments in 2020, compared with 53% of CFOs across industries. Where there was a negative effect, it was most likely due to supply chain disruption and cancelled or deferred elective procedures.

Still, 77% say their capital allocation process is only somewhat or not very successful. Barriers to success include lack of access to data (52%), lack of monitoring performance (49%) and inability to accurately prioritize projects (47%).

Q **What are the primary barriers to your company's optimal allocation of capital?**



78%

of life sciences CFOs say they plan to increase digital technology investment in 2021.

What changes will stick?

A key to improving the capital allocation process is to make sure investments are aligned to the company's long-term strategy. In order to do this, life sciences companies need to decide which changes spawned by the pandemic will stick and which are temporary.

Aside from possible reshoring or near-shoring automation and the use of mRNA technology, the pandemic also highlighted the value of technology, including the rise of telehealth, the use of artificial intelligence (AI) and other technology to conduct clinical trials and to assist in R&D. More than three-quarters (78%) of life sciences CFOs say they plan to increase digital technology investment in 2021, which may reflect a belief in the long-term changes in technology, including its use in R&D and trials and to digitize the supply chain wrought by the pandemic. MedTech companies are also focusing more on using cloud technology to create connected devices and are facing increased competition from technology giants that are also moving into health care. This raises decisions for companies on whether to develop their own technology, partner with large technology companies or acquire technology startups in order to remain competitive.

Meanwhile, 74% say they plan to increase R&D spending, which, while potentially addressing a long-term need, may also in part be a correction from a decrease in R&D spending in 2020 due to the pandemic.

One medical device maker that is using its capital investments to reinvent itself is Zimmer Biomet, which is shifting from a product-based to a solutions-based organization. Its capital investments over the past three years have positioned it to deliver value to patients and physicians beyond the operating room. With the launch of Persona-IQ knee implants, it will be able to offer an integrated experience pre-, intra- and post-op for all stakeholders. EY teams helped Zimmer Biomet translate this vision into an actionable go-to-market launch strategy and initiated a shift in how the company made money, allowing Zimmer Biomet to move to a model driven by data and the company's platform rather than based on manufacturing and selling knee implants.

Rebalance, recharge and communicate

Overall, 68% of life sciences CFOs say it's time to rebalance the company portfolio to focus on their core business, with 47% saying there is an opportunity to recharge or reinvent through M&A.

Communicating a consistent message to key stakeholders about the long-term strategy and how capital allocation decisions support that strategy is essential to prepare stakeholders for the impact of any capital investments. For life sciences CFOs, suppliers were the most likely stakeholders to be addressed (named by 60% vs 52% across industries). Life sciences companies need to discuss demand and supply planning, procurement, distribution, and inventory plans with suppliers so that they can be aligned with how the company plans to meet its goals, especially as supply chains are revamped.

Employees are another key constituency but named less frequently by life sciences CFOs (58%) than by those across industries (69%). This could be an area of opportunity, as people and corporate culture are key elements of strong capital allocation strategy that instills personal accountability, involves partners or other influential leaders so new assets are integrated into the larger business, empowers project owners, and develops an organization-wide definition of "winning." This is even more essential as companies transform their business models, which can create uncertainty for employees.

76%

of life sciences companies say safety and regulatory requirements are less frequently cited in life sciences capital allocation decisions.

65%

of life sciences CFOs say impact on sustainability has become a more important factor in their capital allocation process over the past year.

Bringing qualitative KPIs to the decision-making table

As in all industries, life sciences CFOs are well aware of financial KPIs, such as growth rate, R&D spending, free cash flow and return on invested capital. But aside from supporting financial value, KPIs should also be used to reflect patient value (such as the impact of certain treatments), customer value (such as satisfaction and loyalty), people value (such as employee engagement and diversity and inclusion) and societal value (such as carbon footprint and ethics).

Some of these are reflected by KPIs considered by the majority of life sciences companies, including safety and regulatory requirements (76%) and workforce impact (61%). Environmental impact (37%) and social impact (21%) are less frequently cited in life sciences capital allocation decisions but may need to be factored in more as environmental, social and governance (ESG) criteria become higher priorities for regulators, lawmakers and investors. In fact, the majority of life sciences CFOS say impact on sustainability (65%) and impact on diversity or social goals (61%) have become more important factors in their capital allocation process over the past year. KPIs should also be reviewed regularly, and those that did not lead to long-term value investments may be discarded for new metrics that more closely align with the current strategy.

In order to weigh qualitative KPIs on equal footing with quantitative metrics, life sciences companies may consider employing a balanced scorecard approach that can weigh both qualitative and quantitative factors and provide for an objective analysis of investment opportunities. Analytical tools and technologies improve the effectiveness as your capital allocation process by allowing you to:

- Perform look-back analyses to assess the quantitative and qualitative assumptions versus actual performance
- Develop a central repository for relevant historical and current data
- Define and measure KPIs consistently
- Create robust analyses that include various scenarios, update and monitor performance
- Using real-time data
- Provide key stakeholders consistent information in a useful format

A holistic approach to capital allocation

It's clear that life sciences CFOs think they need to take a new approach to capital allocation. They need to look beyond the bottom line and take a holistic view of how capital allocation decisions bring long-term value to all stakeholders, not just shareholders.

A process that aligns with the company's post-pandemic strategy, brings rigor that allows for consistent decisions across the organization and weighs qualitative KPIs on a scorecard with quantitative metrics can help the capital allocation process support long-term growth.

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