

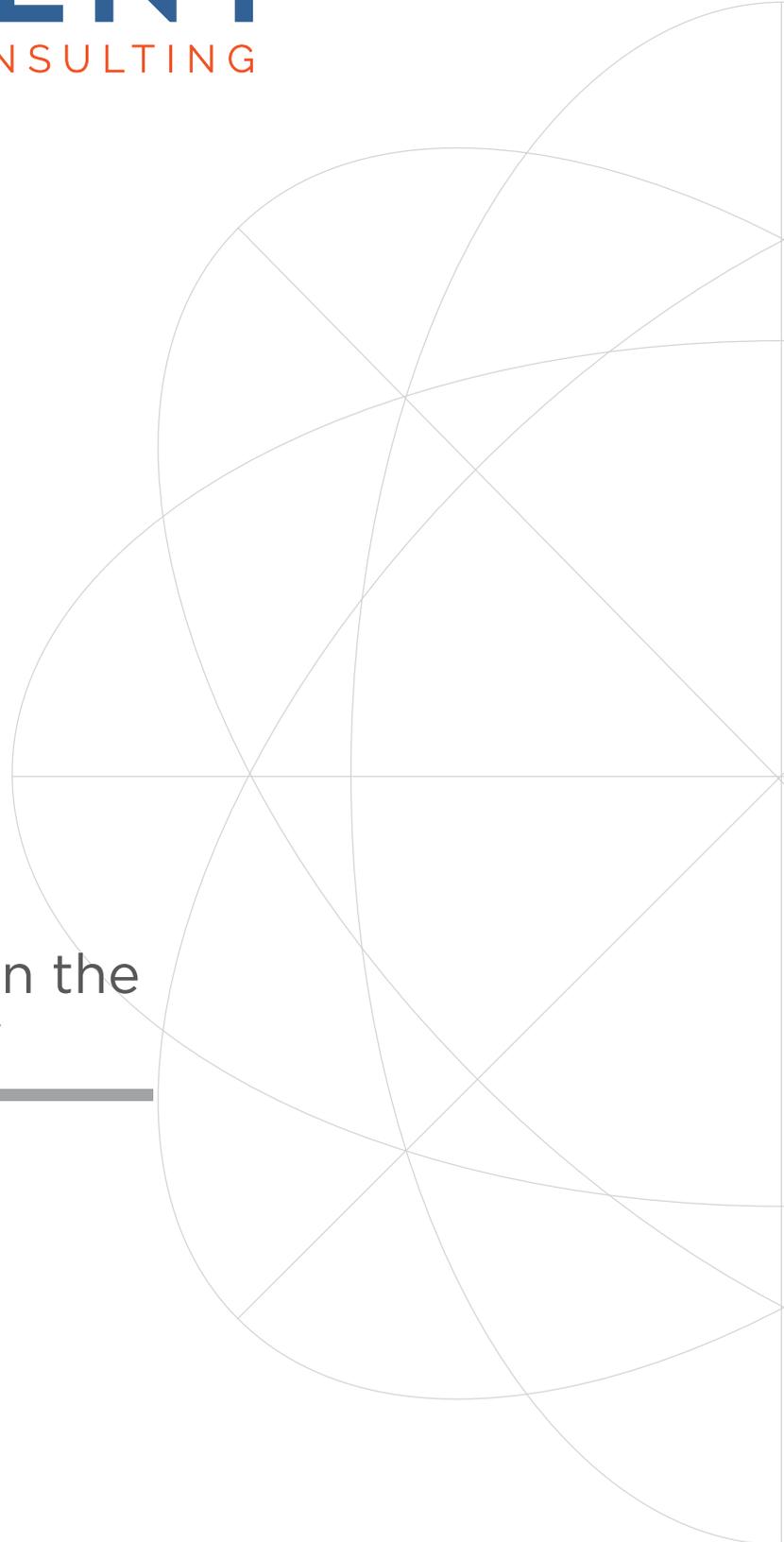


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Facilities Management Outsourcing Strategies in the Pharmaceutical Industry

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STRATEGIES IN OUTSOURCING FACILITIES MANAGEMENT

Overview

The pharmaceutical industry has faced significant competitive pressures over the past several decades that continue unabated. These pressures have led to interest in and adoption of new, more efficient and scalable operating models. Outsourcing is a major strategy that the industry has adopted across a broad range of value-chain activities. One key area where outsourcing is being increasingly adopted as an operating model is facilities management, a major indirect cost category that spans R&D, technical operations, and commercial facilities. Research shows that the level of market request for proposal (RFP) for facilities management is experiencing on average 25% growth driven by Europe where RFP growth rates have jumped 50%¹.

Despite the increased adoption of the model, there is still a need to better understand how the outsourced facilities management model can succeed, particularly in manufacturing and development facilities that have different constraints and requirements than commercial offices, where outsourcing is more commonly applied.

Facilities management is comprised of a broad range of activities ranging from utilities-plant maintenance, building maintenance, and engineering to mailroom operations. At research sites, the definition of facility management can also include laboratory-related services, such as glassware services, fume-hood maintenance, and some laboratory equipment calibration. Table I includes the broad categories of services that define how facilities management is being interpreted in the pharmaceutical industry and the services included in facilities-management outsourcing.

Table 1: Categories of service typically included in facilities-management outsourcing contracts

Services	Definition	Inclusion
Facility management functions	Planning, budgeting, common help-desk operations, and call-center functions	Generally Included
Site maintenance	Building-maintenance planning, scheduling and execution and site infrastructure	Generally Included
Small projects	Moves, adds, and changes as well as expensed repairs	Generally Included
Cleaning services	Interior and exterior cleaning, landscaping, pest control	Generally Included
Dining services	Catering and cafeteria operations	Generally Included
Security	Physical guard services, fire brigade	Generally Included
Utility plant	Utility-plant maintenance	Sometimes Included
Laboratory support services	Calibrations, glassware, and laboratory supplies	Sometimes Included
Waste	Waste management and handling	Generally Included
Logistics	Receiving dock operations, shipping, and mail	Included
Employee amenities	Fitness center, childcare, and medical services	Generally Included

1. R. Kishan and M. Marcum, Global Trends and Activity in the Real Estate and Facilities Management Outsourcing Market, (UMS Advisory, Arlington, 2010).

Some services listed in Table I were included even if they are performed in a cGMP setting. For example, cGMP cleaning is listed as generally included. However, cGMP production-equipment maintenance is almost never included in first-generation facility-management outsourcing initiatives. First-generation outsourcing refers to the initial outsourcing effort that typically involves transfer of people, processes, and some assets to a third-party supplier, and second- and third-generation outsourcing refer to re-bidding or re-negotiating the initial outsourcing contract. First-generation outsourcing is typically characterized by a focus on human resources terms and change management in adopting an outsourced model, and second- and third- generation initiatives typically focus on further leveraging the strategy. There are only a handful of cases where cGMP production-equipment maintenance work was outsourced to facility management companies—these were experienced, third-generation outsourcing practitioners.

There are exceptions to the general inclusion of the scope identified in Table I because of plant-specific considerations. For example, at a sterile facility, related heating, ventilation, air conditioning (HVAC) maintenance was not included because it is considered to be a key part of the product environment. The strongest determinant of what scope was included in a first-wave initiative was the sponsorship of the outsourcing project. Initiatives that were sponsored by a cross-functional executive steering group comprised of technical operations executives, chief financial officers (CFOs), sector leaders, and chief procurement officers (CPOs) tended to have the broadest mandate and consistent inclusion of services across sites. If, however, the sponsorship was primarily at a local level, scope was typically limited, and many plants and sites opted not to participate or participated in a limited way. The highest variance on scope inclusion was around technical services such as building and utility plant maintenance.



The observations in this article are based on the author’s experience with the client assignments listed in Table 2. Some companies in Table 2 are now in their second- or third-generation facility management outsourcing initiatives. These pharmaceutical companies are US- and EU-based companies, and outsourcing initiatives are within the pharmaceutical industry, and more specifically within plant manufacturing environments.

Table 2: Example client reasons for in facilities-management outsourcing				
Services	Geography	Portfolio	Annual Spend	Generation level of outsourcing
Pharmaceutical company #1	All US sites manufacturing	Office, laboratories, pilot plant (no manufacturing plants)	> \$90 million	1 st
Pharmaceutical company #2	US, EU, and Asia sites	Mixed-use, research, sales offices, and other offices	> \$300 million	1 st
Pharmaceutical company #3	US and Puerto Rico	All office, laboratories, and manufacturing	> \$110 million	3 rd
Pharmaceutical company #4	US and UK sites	All offices and laboratories	> \$200 million	1 st
Pharmaceutical company #5	US sites	20 manufacturing plants	> \$90 million	1 st
Pharmaceutical company #6	EU sites	40 manufacturing plants	> \$240 million	1 st

A facility-management outsourcing strategy typically starts with a US initiative, quickly followed by a second wave of implementation targeting manufacturing sites (if not in the first wave) or new geographies (e.g., EU or Asia). The first key finding is that pharmaceutical companies are expanding facility management outsourcing initiatives both geographically and functionally across divisions, indicating an increasing rate of adoption of the outsourced facility-management model.

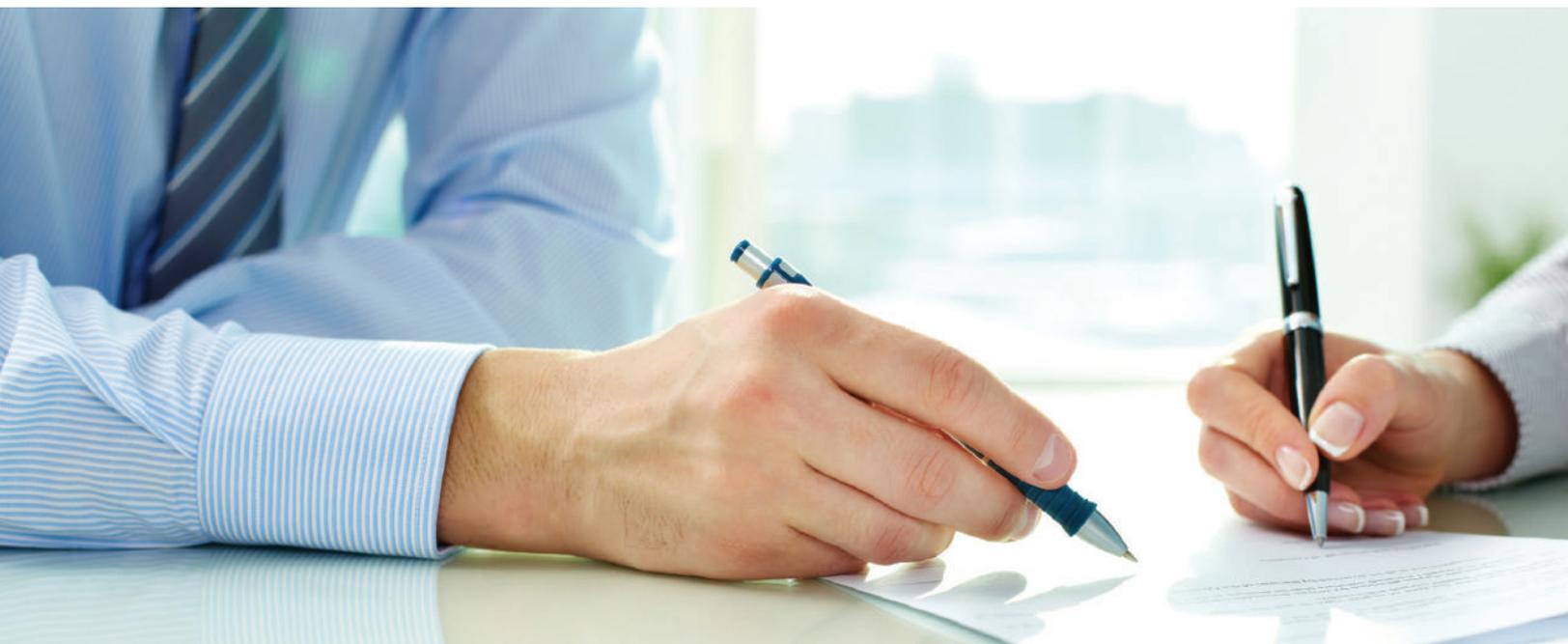
The companies represented in Table 2 pursued the facility-management initiative for several key reasons:

- Facility management services are noncore services, which are business critical nonetheless, especially within the plant environment
- Most of these services are managed locally under prescriptive, task-based contracts that lack modern day contractual provisions for continuous productivity, scalability, and performance guarantees
- The number of contracts can be in the thousands, thereby impeding scale, efficiency, and market leverage
- Suppliers are delivering savings by bringing a new operating model to pharmaceuticals; savings are increasing due to market maturity and scale
- Process inconsistency and variance in practices across sites result in disparate financial and operational performance that outsourcing can address
- Aging workforce demographics and headcount constraints make outsourcing an attractive option

Consideration of these factors has prompted large pharmaceutical companies to launch initiatives in this area. Companies such as Pfizer, Merck, Amgen, J&J, Novartis, Eli Lilly, and others have pursued leveraged facilities-management outsourcing. RFP results show the economic benefits of outsourcing where savings across five-year contract terms are averaging between 15%-19%. In addition, these results are consistently strong across North America, Europe, and Asia. Even companies in the third generation of facility-management contracts continue to see efficiencies. Financial gains across generations of contracts are in large part due to the maturing of the supplier market, cultural adoption of outsourcing, and stronger governance structure and processes; these factors further enhance the leveraged outsourced model. For example, in a third-generation contract case, a client added significant cGMP vessel maintenance work to scope. Another third-generation customer added laboratory support services to scope where they found new sources of efficiencies. The latter resulted in a shift of work from a scientific-services provider to a facilities-management provider.

The six pharmaceutical companies profiled in this article represent a five-year total contract value of more than \$6.5 billion. Efficiency gains resulted in net present value (NPV) calculations of several hundred million dollars for these companies. Based on savings and NPV impact, the second key finding is that facilities management outsourcing has become a key efficiency lever. This lever, when applied across the network of manufacturing plants, and research and office campuses and sites can present a compelling value proposition.

While the portfolio level savings are consistently high, plant-specific business cases can vary considerably. The observed variance in site-specific business cases suggests that the operating model is scale-dependent in terms of reliably predicting an efficient outcome from the effort: a small, localized pilot effort across a handful of sites is unlikely to consistently match the effort produced by broader-scale outsourcing initiatives. Savings come from several sources for pharmaceutical clients: standardized processes, leveraged contracts, application of technology, cross-functional deployment of labor, management, and overhead scale efficiencies.



IMPLEMENTATION FINDINGS

Implementation observations can be classified into two broad areas: implementation of the RFP sourcing process and implementation of the signed contract.

Implementation of the RFP process

In the RFP process, there are several complex challenges that need to be addressed. The decentralized plant environment makes it particularly challenging to achieve an RFP scope with minimal unexplained variance. Disparate, inconsistent scope across plants can be a barrier to realizing scale in outsourcing efforts. Secondly, given the intimacy of some services (i.e., water for injection [WFI], instrument calibrations) with manufacturing or science, the sourcing process itself needs to be business interest led. Initiatives that were primarily purchasing led with inadequate business participation required greater process intervention and longer implementation schedules. Determining the scope of the RFP is a complex decision that many businesses found hard to frame consistently as a business case. Finally, the sourcing strategy itself, from the commercial model to scope options, was subject to debate across a wide divergent of opinions across procurement, technical operations, the finance department, and facilities-management groups. Divergence of opinion without effective frameworks and processes for decision-making risks compromised decisions may undermine the attainment of efficient bids or result in ineffective commercial models that actually increase friction between supplier motives and client-performance objectives.

The RFP process also has additional complexity, particularly in Europe, around the timing of release of human resource notifications and information relating to data privacy and labor laws. Poorly managed and timed notifications and information can result in unnecessary worker anxiety.

Successful initiatives were business-led, where purchasing was a key executive sponsor, advocate, and stakeholder. Initiatives with the right executive governance, project teams with prior outsourcing experience, and cross-functional representation were able to more effectively navigate decisions, manage cultural resistance, and stick to milestones. Teams with limited prior experience in outsourcing implementation of similar scale and complexity were not effective in leading such large-scale initiatives.

In cGMP environments, site heads and their operational staff have particular concerns around how outsourcing will affect their ability to use shared staff. They are concerned whether a central contract structure will impede local operational decision-making, cause a loss of critical operational skills, and about how the contract will work post signature. These questions have to be addressed head on at the beginning of contract design to build buy-in and alignment.

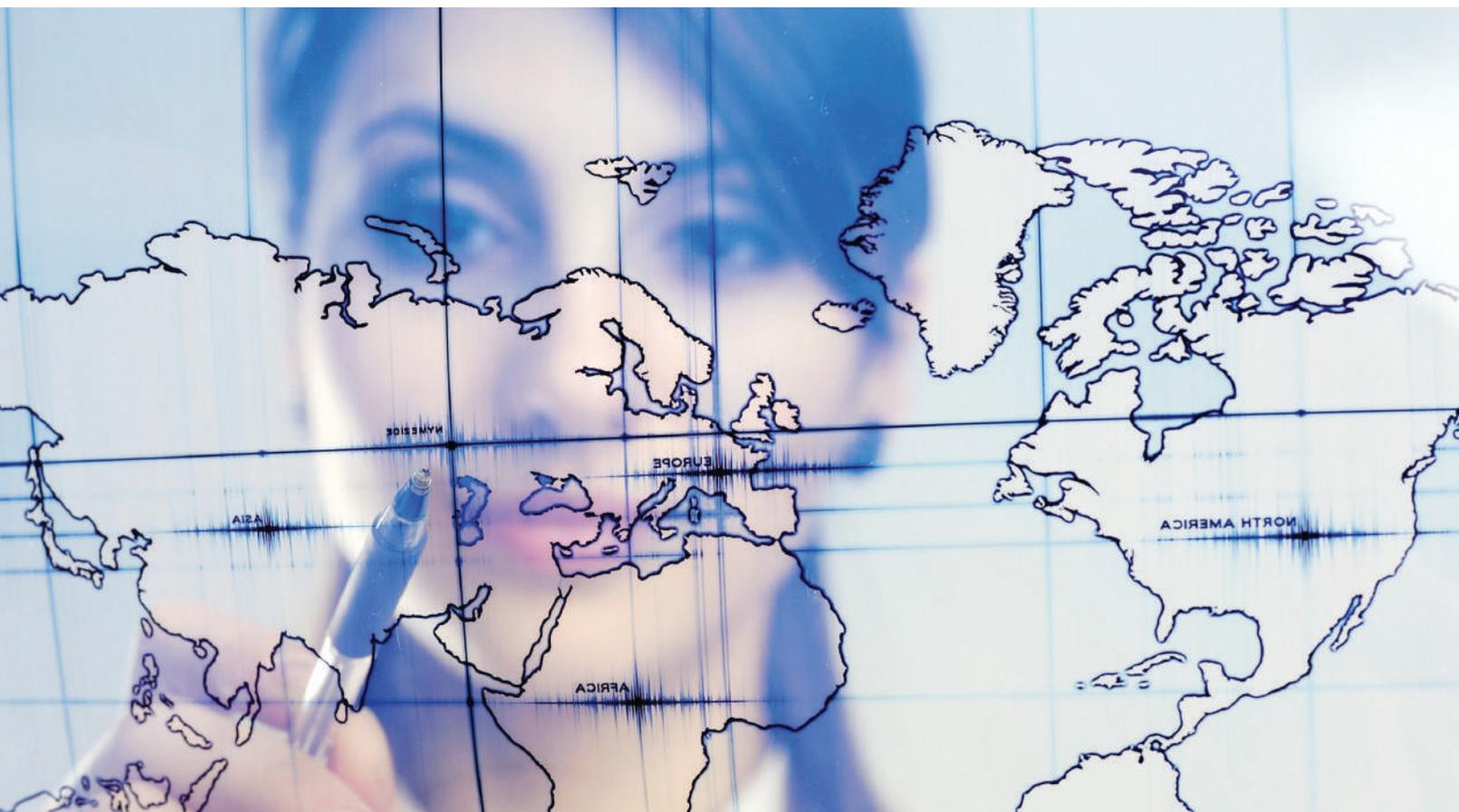
Implementation of the signed contract

The implementation of a facilities-management outsourcing contract requires considerable engagement of cross-functional resources, coordination, and creation of governance processes. In outsourcing, the primary considerations have to do with the human resources terms for the transfer of employees. When the right human resources terms were used (i.e., terms that promoted continuity of employment and limited turnover), transitions and implementations went smoothly. The supplier market has done well in retaining and deploying transferred pharmaceutical staff. In the rare instances where human resources terms were not conducive to employee transfer, turnover was high as was employee anxiety. Another major observation during implementation was that some clients found themselves in protracted baseline disputes and issues with the outsourced provider.

First-generation outsourcing issues stand in contrast to those found in third-generation outsourcing. In third-generation outsourcing, the primary considerations have to do with engaging market interest, tapping into supplier innovation, and making supplier-switching decisions. Experience in third-generation outsourcing indicates that suppliers that did not innovate and bring new, fresh thinking to ageing accounts faced the highest level of risk of sponsor companies switching outsourcing providers.

In some cases, clients switched out long-standing facilities management suppliers in the third-generation RFP. What's reassuring is that these transitions were well executed with fairly good cooperation from the incumbents. The pharmaceutical industry has demonstrated that it can enter into complex facilities-management outsourcing contracts when necessary, and also exit incumbent contracts without operational disruption when required.

The pharmaceutical industry and facility-management suppliers have effectively managed the transfer of thousands of employees from pharmaceutical facility management to supplier facility management organizations using effective human resources terms. Baseline development mechanisms (such as classifying total internal and external costs according to a common set of service definitions, and disaggregating on-time costs from on-going costs) are still maturing, and strong financial and contractual controls are needed to avoid protracted issues. Finally, continued supplier innovation and contribution (e.g., new practices from other accounts, well planned execution of business pressing initiatives, and anticipatory relationship posture) in outer contract years are key predictors for full retention of third-generation accounts.



CONCLUSION

Facilities-management outsourcing has become a key efficiency lever for the pharmaceutical industry, and initiatives are expanding geographically and functionally. Successful outsourcing initiatives are business led and require strong executive governance and project teams with prior outsourcing experience and cross-functional representation.

Baseline-development mechanisms are still maturing and strong financial and contractual controls are needed for effective supplier management. Continued supplier innovation in the outer years is a key predictor of account retention. In large part, suppliers continue to perform operationally well across most services. Cost and effectiveness are the two primary objectives for outsourcing.

The two key areas of development for the industry, however, are in institutionalization of governance structures and processes, and improvements in financial and contractual controls. The former is required to effectively transition culturally from legacy operational models to supplier-relationship management models. Without effective executive oversight, such change is unlikely to be accomplished on a sustainable basis. And secondly, the market continues to show opportunity to advance in the areas of financial controls and contractual mechanisms for flexibility and change. Companies that take steps to institutionalize governance and build strong financial controls are able to avoid some of the pitfalls mentioned. Finally, suppliers and clients who jointly focus on third-generation innovation are also able to continue to find new sources of improvement as they enter into the third generation of relationships.

ABOUT THE AUTHOR



RAKESH KISHAN, MANAGING PRINCIPAL, EMEA

Rakesh Kishan is a Member of the Global Board of Trascient Management Consulting, LLC and the Managing Principal for the EMEA region. He has advised Fortune 500 companies on enterprise-wide RE/FM initiatives to strengthen organizational effectiveness, create greater value to customers, and increase efficiency and innovation through best practices. He has led improvement efforts of high-value asset portfolios comprised of manufacturing, lab and office campus settings of pharmaceutical, high-technology, manufacturing, and financial services sectors. Given his experience in benchmarking and operational excellence, Mr. Kishan has defined the three stages of maturity of a RE/FM organization and the critical enabling steps needed to enhance the value to the enterprise.

Mr. Kishan is an expert in the growing market for outsourced integrated FM services. He has spearheaded outsourcing initiatives on a global scale and within diverse portfolios of manufacturing plant, lab, and office settings. He has negotiated FM deals with individual contract values of up to a billion dollars. In this capacity, Mr. Kishan has advised major corporations in virtually all aspects of the entire outsourcing life-cycle: from structuring global Facilities Management outsourcing initiatives, to optimizing governance structures and processes for sustained realized improvements, and to implementing interventions to renew troubled relationships. In particular, he has pioneered innovative approaches to structuring contract pricing to foster continued supplier innovation across each stage of the contract life-span.

Mr. Kishan has written for and presented at RE/FM organizations and publications in the US, UK, Canada and Japan on outsourcing and performance improvement in Facilities Management. He has been a keynote speaker at BIFM and also speaks at the CoreNet Global Summits, ISPE and IFMA chapter events. His articles have been translated into Japanese for the JFMA. He is a contributor to many industry publications on issues related to Real Estate, Facilities Management and Outsourcing. He is the chair for the annual Trascient Strategic RE/FM Conferences attended by leaders in RE/FM. In addition, he is the editor of Trascient Perspective, a thought leadership journal dedicated to advancement of RE/FM.

Mr. Kishan holds a Masters in Business from Columbia University, a Masters in Government from the University of Pennsylvania, a BS from the University of Wisconsin, and a BSc in Physics, Mathematics, and Chemistry from the University of Delhi.

ABOUT TRASCENT

Trascent, a premier global management consulting firm, drives measurable performance improvements and generates quantifiable results in Real Estate and Facilities Management (RE/FM). The firm's clients span biopharmaceuticals, consumer packaged goods, diversified industrials, financial services, high technology, media, oil and gas and other sectors. Main areas of focus include sourcing, governance, technology strategy and enablement, portfolio and workplace optimization, organization optimization and operational improvement. Trascent's top-rated industry conferences have been attended by senior RE/FM and business leaders from more than 100 companies in the United States, Europe and Asia. For more information, visit www.trascent.com

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