# Spend Like an Investor


Professional investors are a fascinating group of individuals. They enjoy an incredibly direct link between results and reward, so a lot can be learned from understanding how they focus effort. Essentially investors put all their energy into two things before deploying capital:

1. Finding ideas/teams/businesses that promise return on investment
2. Stress testing the promise of the money multiplier by integrating data, opinion and evidence

Pharmaceutical companies tend to adopt these two behaviours only when deploying substantial amounts of capital on M&A. However, the inertia of day-to-day spending allows much larger amounts of capital, albeit in small tranches, to be burned on accepted legacy activities that poorly reflect the true needs of the business as it evolves to meet new challenges. Is maintaining that marketing authorisation in the Seychelles really driving value for the company? Often the answer is no, but the region head or general manager really wants it to happen to meet his or her top-line and P&L target, and so the money gets spent with minimal scrutiny. This pattern is endemic in the pharmaceutical industry, and companies are often guilty of thinking in terms of very high-level line items without creating the time, culture or capability to really dig around in the P&L to find the opportunities for faster growth or reduced spend that will increase return on investment.

Bad 'investment' behaviours are sadly common, and when we analyse an organisation's expenditure, we regularly see no year-on-year variation in such 'momentum' spends. This strongly suggests that there is insufficient rigour in budget planning, governance and management. Variation and movement in budgets are indicative of higher quality choices, more akin to investment decisions than spending. Yet planning and budgeting processes often reinforce the "same as last year but a bit less" approach to functional cost budgeting, with a mindset of if we spent it last year we need to spend it next year. Not all momentum spend is bad or unnecessary, but a systematic approach to evaluating investment choices can create substantial margin opportunity and foster a culture that connects spending with return on investment rather than a historical right.

Our experience is that although periodic cost-cutting initiatives to please investors and defensive M&A with targeted synergy savings are the meat and drink of larger pharmaceutical companies, systematic approaches to on-going expenditure management are rare in the pharmaceutical industry. Companies typically take distributed, ad-hoc or reactive approaches rather than search strategically for P&L improvement opportunities across the business. As pricing pressure in the market intensifies and as health economies across the globe constrain further the use of new innovative medicines, companies must build a more rigorous approach to value generation. Weaving an investor mindset into the fabric of an organisation creates a business with margin at its core.

> **"foster a culture that connects spending with return on investment"**

Achieving this is no small task, but the rewards can be substantial. Senior management must lead the mindset shift by setting challenging objectives and putting in place the capabilities and decision rights to identify and release margin at pace. This is particularly important in the major cost centres of supply chain, sales & marketing, and R&D.

Organisations do tend to build up inefficiency over time, so spending cannot be left as the sole preserve of the financial control function. Everyone in the organisation has an important role to play in challenging and aligning expenditure to the critical drivers of performance. Management can start by communicating very clearly that the organisation needs to think differently about its responsibilities. Proactive and ambitious leaders can create an investment-centric organisational mindset through three key activities:

1. Establish an Organisational Mission: Set a clear challenge to the whole business to start proactively finding opportunities to improve margins and return on investment without impacting value creation

2.Commit Senior Leadership Energy to the Change: Appoint a 'Margin Ambassador' or build task forces to coordinate a systematic review that enables understanding of ongoing activities, creating a unified perspective on the nature of investment and return in the whole P&L, and identifying strategic opportunities for margin improvement

3. Build Insight on the Profit and Cost Drivers: Assemble and propagate evidence around the drivers of profit and cost in the business and encourage a proactive dialogue about investment choices to ensure that capital is allocated optimally for return

The opportunity locked inside an organisation's P&L will differ tremendously by geography and function, but it will be there. Leaders should seize the opportunity to understand their businesses better and support their employees in becoming real experts in the efficient delivery of performance. Breaking the cycle of momentum spending will take a concerted effort, but it will dramatically improve the resilience, effectiveness and performance of any organisation.



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