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Navigating Unpredictable Waters

Strategies for China's Pharma Market Future

By Franc Kaiser | November 2009

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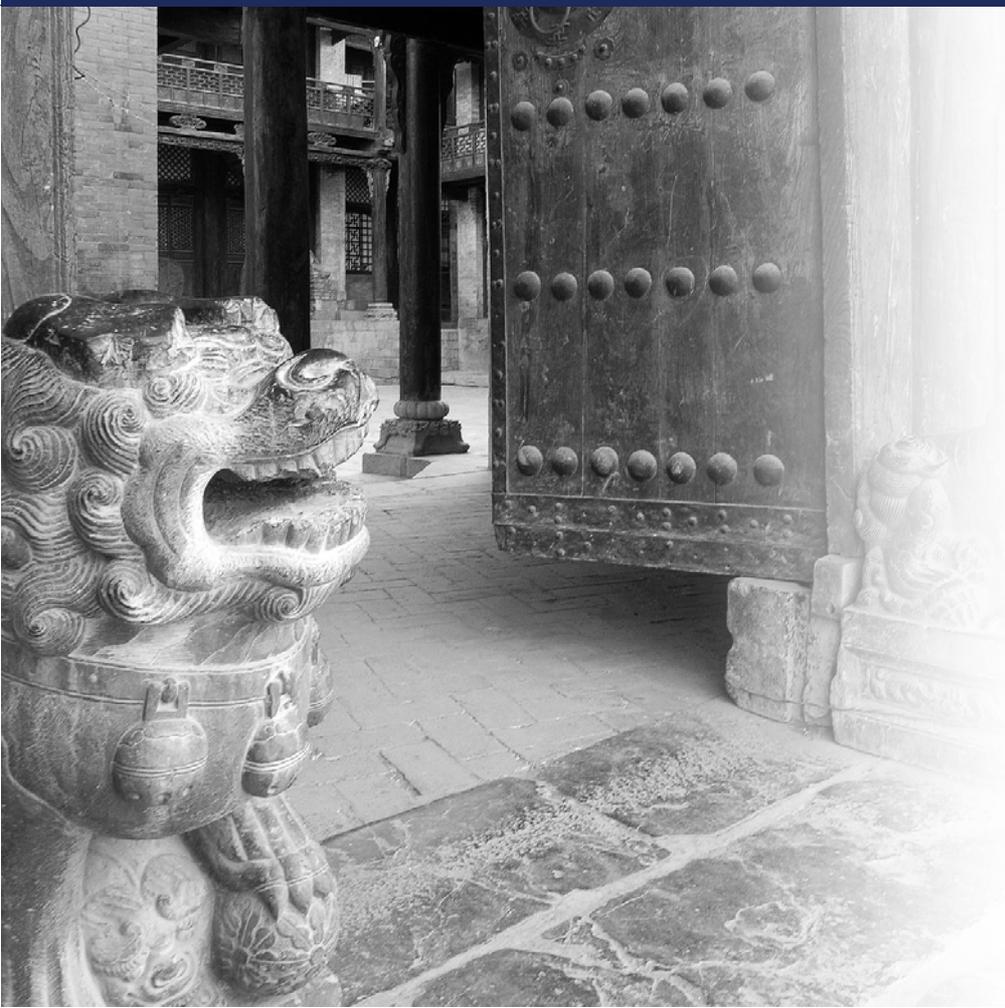
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China's huge population of 1.3 billion people, many of them just beginning to use western modern medicine, is a potentially giant market for pharmaceuticals. Many multinational pharmaceutical companies are betting on future expansion in China, though their sales in the mainland now account for less than 3 to 4 percent of their global sales despite huge investments and efforts over the past 20 years.

Though all involved expect China to eventually become the world's largest pharmaceutical market, it is a field still rather mysterious and hard to predict for many foreign pharmaceutical players. "I could never have correctly envisioned that China would be at where it is right now. So when I try to predict the next 20 years, I can also not figure out exactly how it will look," William Keller, a former general manager of Roche China, told InterChina in an exclusive interview at his office in Pudong, Shanghai.

Keller, a Swiss national, started his career with Roche in 1972 in Switzerland. He worked for Roche's nutrition division and also worked as deputy general manager in Brazil and Columbia. He was appointed general manager of Roche China in 1990 and was tasked with building up its operations here. He helped set up 6 China joint ventures and a holding company, including an R&D center and plants. Keller was in charge of Roche Pharmaceuticals, one of two main divisions of Roche China, between 1994 and 2002, and was also general manager of Roche China Ltd., its China holding company.

While working in Shanghai the city recognized his efforts - including speaking on behalf of Shanghai's successful bid in 2001 for the 2010 World Expo, by making him an honorary citizen. After leaving Roche in 2003, Keller stayed in Shanghai with his family and formed a consulting company, Keller Pharma Consultancy (Shanghai) Co., Ltd. His office, based in the Shanghai Pudong Zhangjiang Pharma "Valley," advises the government on strategies for promoting the high-tech industrial park. Keller also is a director of the board of several companies in and outside China, and advises medium-sized pharmaceutical companies on their strategies for China.



William Keller
General Manager,
Keller Pharma
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China HealthCare Reform

InterChina Consulting: China's healthcare reform has been the focus of discussion in the last few months. If you look into the future, where do think China's healthcare system is headed? What kind of system will China have in 20 years compared to now?

William Keller: This is a question I have asked myself many times in the last 20 years. However, you cannot take an existing healthcare model and compare it with China. I believe China will become its own model, tailored to the needs and ambitions of China. I also think that there will be a pharmaceutical market with Chinese characteristics. What I am sure about, though, is that China will have a major influence on the global market and also on other healthcare systems. We should not think about teaching or lecturing China on what they should do. Maybe we can learn something from China instead, since it will have an impact on the global healthcare business and pharmaceutical industry.

What will really change?

It's the broad coverage that will be widened and established. I am also sure that the reforms will have some success in changing the system from hospitals to clinics – this will be more difficult as you have to change people's habits and the services provided, and the choice of drugs must be attractive to the patients. This will take time. Now, I hope that we'll see a system like a basic insurance supported by co-payment system, where the government looks after the basic system, and then is topped up by insurers and co-payers. The reform is an enormous undertaking with no parallels in the world and it's being done in a quite comprehensive and careful way. This task cannot be completed in the next 5 years - this is a task for a generation.

I don't think the problem of drug prescription and drug dispensing¹ will really be solved in the short-term. This will remain an issue for a long time, because remuneration and incentives for doctors must be reasonable and fair. However, an important-and often overlooked-point to notice is that doctors are now allowed to practice in more than one location or practice. This gives them better

opportunities and makes it possible for them to practice in front-line clinics.

How do you see the definitions of the essential drug list and reimbursement lists shaping up? Is this a black box for MNCs?

No, the way the Chinese authorities are handling these lists is very transparent, but it's also a very difficult task. There are many, many interests which are difficult to balance. You have regional and local interests, you have industry interests. There are many parties the government must listen to. The authorities are actually very open to suggestions and opinions of foreign players - they actively consult the different players.

How worried are the MNC pharmaceutical companies about this? They may not be that worried about eroding innovative margins, but what are they doing against this?

The list will have a certain impact, but I don't think in the short-term that we should expect a "revolution" - it will be rather an evolution. The big pharmaceutical players are quite active in supporting the Chinese government and they support the healthcare reform. Of course, the research-based companies, and also the home-grown innovative companies, are concerned that innovation won't be rewarded in the future.

Another concern is 'quality'. After unfortunate accidents and developments in the recent years, the Chinese government is aware of quality issues, and is looking for 'better quality, better price'. The government understands that a low price without any quality is meaningless. So, the government tries to reward innovation on one hand, but also to reward producers who provide quality. In every healthcare reform, the key to everything is standards, the quality. So there are

“The Chinese government understands that a low price without any quality is meaningless.”

¹ In most Chinese hospitals, the dispensing of drugs is not separated from the prescription

now some discussions how ‘quality’ can be built into the pricing systems, to find some objective - or more objective - criteria that allow fixed prices which in turn allow the motivation of quality through price. This applies especially for generic drugs. For innovation, there is also some effort there. The problem in all these discussions is to find the starting point. Pricing incentives are probably a good way to create quality, by setting incentives for a higher price, if you can put in a certain quality. The same is obviously true for innovation.

The Chinese Players

So, Chinese innovators could be actually further incentivized by such a system?

They should be!

However, it seems that Chinese players will become even more generic...

No, the question should not be ‘foreign or local’ – the question should be whether the player achieves cGMP (current good manufacturing practices). We should distinguish standards, and those standards should move up in line with global quality standards. This would also help globalize the Chinese pharmaceutical industry. Therefore higher standards will also favor local players, because once Chinese players reach an international level in manufacturing, the global market will be open to them.

Do you see a certain legion of Chinese innovative players arising?

This innovation movement started around the year 2000, though the majority of Chinese innovators became visible around 2004. Of course, the buildup of an innovative industry takes time. Now we already have very high-level CRO² companies. There will be good innovative companies - but first we’ll see very good generic companies. There are actually quite a number of Chinese companies good at discovery, but the big challenge for them is to find good people to further develop and launch their products. Hence, the innovative field basically is still dominated by MNCs right now, but Chinese companies are going to catch up.

Furthermore, it will now be just a matter of time until Chinese products developed by Chinese companies will go global.

When do you see this happening?

In 10 years from now. There is an interesting development taking place. For example, Novo Nordisk is building a big insulin plant in northwestern China, and some MNCs are exporting finished preparations already. We see the first plants specifically built for exports, too. This is irreversible.

**“In 10 years,
Chinese
innovative drugs
will go global.”**

These companies can do this because they have easy access to global customers. For API³, it worked very well, but now there are plans by Chinese players to build formulation plants⁴ in China for exports.

For a Chinese company, exports of finished preparations are much more difficult. You can build a plant, but where are the customers? This will probably happen in two steps. First, they start from the CRO model, serving their customers. As a second step, they add manufacturing capabilities (CMOs⁵), producing finished preparations on behalf of their customers in export markets.

In a way, this will be a different route compared to other industries, which started with OEM products for export first and only at a later stage went into design /innovation / development. Chinese pharmaceutical players will do it the other way round.

² Chinese Contract Research Organization

³ Active Pharmaceutical Ingredients, or also raw chemicals for production of finished preparations

⁴ Finished preparations.

⁵ Contract Manufacturing Organization

There is an on-going debate over whether CROs are cheaper in China.

The issue of being cheap or cheaper is probably not the key reason why Chinese CROs are successful. These CROs land contracts because they are flexible and fast. If you look at really successful Chinese CROs - which are also active for global customers - their major strength is their flexibility, and their ability to scale up very fast, and also provide good quality. Yes, they are also cheaper. Even in manufacturing in early stage clinical trials, they are much faster than Western companies.

Why are they faster?

Chinese people work harder. I can see this here in Zhangjiang Pharma Valley – people work longer hours, and they are willing to work harder. Costs are certainly going up, but I think it is a dangerous game for a Western player to just wait and hope for labor costs to level out.

The MNC Players

How do you see MNCs reacting to healthcare reform? What are they doing differently now?

MNCs used to apply a “global model” here, but in reality it was rather an Anglo-Saxon market model. Now they are facing emerging markets like China and India, which will become very big markets. The MNCs try to integrate such emerging markets into their global model. However, they find that “global” is not as uniform anymore as they would like to pretend.

I hear MNCs talking about a “BRIC strategy” – that doesn’t make sense at all. To mix Brazil with Russia, India and China - I can hardly see any similarities between these markets, except for that they are fast growing.

“A unified BRIC strategy doesn’t make sense - MNCs have to come up with a local strategy for China.”

So for China, the biggest challenge for MNCs is to understand that they cannot copy their model to China. They should beware the trap of traditional corporate wisdom. They have to come up with local strategies, adapted to the realities of China.

Does this mean “local products, developed for China,” by China organizations independent from their global structures?

I think the ideal China subsidiary of a pharmaceutical MNC is an organization which has a high degree of freedom to choose of what is right in China and for China. Maybe organizations can learn something from China, and bring it to other places and markets. We should not always try to impose our ideas on China. This is basically the biggest healthcare reform mankind has seen so far, and there will be major opportunities, which we don’t or cannot see right now. Some MNCs are actively trying to do so.

What are those MNCs doing or trying to do in China?

After marketing, sales, and manufacturing, R&D is moving finally to China. Hence, many MNCs conduct

research in China, and now also development. Most of the big pharmaceutical companies have moved major development hubs to China. Doing R&D here helps them to better understand the local disease patterns and local patients and also they learn important lessons on how to integrate Chinese R&D into global activities.

Another frontier for MNCs is their organization in China. I still see very complex matrix structures, which are going completely against the grain of Chinese culture, and they are very difficult to manage.

I see MNCs taking various different routes in China when it comes to product strategy, on the question of which products they should carry. There are still a few which go the old way by putting all their efforts into new products and neglecting product life cycle management with “Chinese characteristics.” Of

“Product lifecycles are different from in developed markets - older products have much more market value in China.”

course, you have to develop and launch new products, but the current portfolio and life cycle management is very important as well. This is because product lifecycles in developed markets are different from in China.

Here, there is a much higher brand awareness among patients and doctors towards the drugs (i.e. because of quality issues), and it just doesn't make sense for MNCs to neglect trusted product brands.

As a solution to this, some MNCs are now trying to acquire local companies, probably with the intention of structuring their portfolio this way. This may be the way to go, but it should be done with a lot of care. If you acquire a Chinese company and integrate it too quickly into the system of an international company, you will damage the local company and lose the opportunity to create synergies. You have to do the integration very carefully and over a long time. There should be a very clear strategy on how to do this.

Do you see M&As actually happening in China's healthcare industry?

Some MNCs are looking for acquisition targets, but there are no real success cases so far. There have been some acquisitions, but in my opinion the integration has been done in too much haste and hurry, and they harmed the good assets, too.

Are the MNCs looking for brands for the generic market? Is this their major objective?

Not entirely - their interest should be to create a product portfolio adapted to the needs of the Chinese market, being aware that China is not ONE market but many different markets in a vast country. An MNC here in China should carefully consider what kind of organization is best to cover the Chinese reality.

MNC's China sales compared to their global sales are still low. What's going wrong here? How can MNCs increase the importance of the China market?

It's true, at first glance, China is still around 3 – 4% of the global sales of the global pharmaceutical companies. But you have to look at this a bit more closely. The MNCs' China products portfolio is much narrower than the global portfolio. If you compare a similar portfolio and sales, or product sales in different markets, and you will find higher figures for China.

Furthermore, rankings in China do not reflect global rankings at all. The largest companies in China are not always the largest companies worldwide. For example, China's largest pharmaceutical company in terms of sales⁶ is Bayer – but they are not the world's largest pharmaceutical company. That shows a bit of the difference and the structure of the market.

⁶ Measured according to hospital drug sales

What do you predict the MNCs will do? Will they bring more products to China from their global portfolio or will they develop products “in China, for China”?

We currently don't have “products made in China, for China” yet. But you have products which are more successful in China than in the global market. Now, with the research building up in China, I am sure that in the coming years the first products will come out from the research pipelines of MNC's and local innovative companies in China.

Most companies pursue a strategy of introducing brands from their global portfolio into China. This brings difficulties, especially in pricing.

Smaller foreign pharmaceutical companies which enter China very much depend on import and distribution partners in China. Do you see any alternatives for such a distribution structure, or is it better left to a local partner?

Distribution in China again is a bit different from other markets. Distributors in China are basically logistics companies, or box movers ... a rather passive affair. Distribution is very regional and local. I don't see any effort to change this. Even the big guys like Sinopharm buy local distributors, and put together a patchwork of distribution points, which is far from efficient or consolidated.

There are foreign drug brands and pharmaceutical companies which have been not very active in China yet. Is a market entry still possible?

If the company features innovative or orphan drugs, there are and always will be opportunities and needs in the Chinese market. In such cases, it makes sense to start with developing import sales rather than setting up a plant right away. For certain niche drugs, the market may be respectable but often not large enough to justify local production. You still have to take it step by step.



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InterChina Consulting

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