

Inroads into China Healthcare Market

By Bill Liang

China's healthcare market, one of the most dynamic and rapidly changing in the world, is creating abundant opportunities -- and challenges -- for both domestic and foreign players. The industry has experienced double-digit growth for a decade, fueled by multiple factors such as an aging population, improving living standards, enhanced health awareness and so on. The gradual transition into a free market economy, coupled with drastic reforms in the sector, has changed the landscape. Such changes have only accelerated with entry into the WTO. As the market matures, we have seen increasing business opportunities for small and medium-sized U.S. pharmaceutical, biotechnology and medical device companies in the China market.

An Industry Overview

The pharmaceutical industrial revenue in China is about \$20 billion USD, of which approximately 48%, 30% and 22% come from the sales of joint ventured, domestic and imported products respectively. Strong growth will continue in the next decade, and the size of the industry will equal that of the United States by 2020.

Recent studies have shown that joint ventures have taken market share from domestic firms, and that sales from imported drugs have remained relatively flat. Although this year's industrial output and sales have increased 17% compared to the same period

last year, net profits in the industry have been squeezed following several radical structural reforms in the healthcare industry. Unlike the mature healthcare market in the United States, China's healthcare market should only be considered a semi-mature market at best, as it mixes many market characteristics of both emerging and mature markets. Some of these features are highlighted as follows:

Fragmentation: China's healthcare market can be segmented by geographical regions and the extent of urbanization. Imbalanced economic development in the past resulted in very distinct coastal vs. inland and rural vs. urban market segments. For example, urban citizens consume more than 80% of healthcare products while accounting for less than 20% of the population. Higher incomes in the coastal areas also lead to better healthcare and more drug consumption.

Overcapacity: The number of domestic pharmaceutical firms exploded by more than 6,000 in the early '90s as exceptional profit in the industry was perceived following the healthcare reforms. Such irrational exuberance came back to haunt the industry in recent years, as most make generic products and compete on price, resulting in profit fallout. The significant push by the government to create top 50s seems to be working following active mergers and acquisitions, and favorable support from the

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capital market.

Low R&D investment and improved awareness for intellectual property. Less than 5% of sales is spent on R&D. Lack of R&D hinders the discovery of novel products. The majority of products undergoing clinical trials are copycats. However, industrial players have been increasingly aware of the importance to develop IP-based products because of improved IP protection and greater marketing edge.

Lack of economic scale in drug distribution. Licensed domestic wholesalers are the only channels available for drug distribution at the present. However, foreign companies are allowed to deliver their own products after January of 2003 according to the China-WTO agreement. Although chain stores with nationwide reach have emerged, more than 15,000 domestic drug distributors still operate regionally. Further consolidation in this sector is highly expected.

Major Industrial Reforms

The industry has been shaken up following the implementation of several government-initiated structural reforms. The main reforms included: 1) requiring all pharmaceutical manufacturers to meet GMP standards by 2004, 2) diminishing drug sales through hospitals 3) bidding publicly for drug purchase, 4) implementing a national healthcare insurance system, and 5) strengthening intellectual property protection and State Drug Administration (SDA: China's counterpart to the FDA) supervision. The goal was to improve manufacturing and distribution efficiencies, strengthen drug safety supervision, and separate hospitals from the drug retailing business.

By 2004, the number of the pharmaceutical companies will be reduced by half as a result of the GMP upgrading push. Hospital reforms are the most complex and difficult, but the ripple effect has resonated across the hospital system today. Loss of drug sale revenue, which accounted for 60% of hospital revenue, will surely take a toll on some poorly-managed hospitals. Complete separation will take another 3 to 4 years, but pressure is certainly building for the hospitals, and drug sales at OTC stores continue to rise steadily.

Public bidding for drug purchases has been implemented widely to curtail inflated drug prices and rampant physician kickbacks. The result of this reform is mixed. In particular, lack of both immediate payment from the hospitals and incentive for physicians has limited intended benefits for both manufacturers and patients. The success of this reform will largely hinge on separating hospitals from the drug retailing business.

China is implementing a basic national

healthcare insurance system, which is designed for employees/workers in urban cities. The government created a list of drugs that can be reimbursed through the national healthcare insurance program. Manufacturers were perceived to benefit from this reform if their drugs were included in the drug reimbursement list. However, the real winners are still those with an upper hand in better quality control and marketing skills.

There are two types of legal protections foreign companies can apply for in China. One is administration protection, which applies for foreign drugs whose patents were granted in their domestic countries before 1993. If foreign companies want to get intellectual property protection, they will have to apply for patent protection in China following the procedures set by Paris Convention. IP right precedes administration protection. IP protection, though not perfect, has substantially improved in recent years.

Tips for Getting into China's Healthcare Market

Two misperceptions are prevalent about the Chinese healthcare market. One is that China is poor, and consumers cannot afford premium products. The other is that everything sells in China, because Chinese consumers love foreign goods. Both are very wrong, because Chinese consumer segments are quite differentiated today, and imported drugs account for one fifth of total drug consumption and high-tech medical devices are mostly imported. One interesting fact: according to some estimates, China may now have more CTs than the United States. On the other hand, not every foreign product has done well in China. Indeed, there is homework that U.S. healthcare companies need to do before jumping into this enticing emerging market. The following questions must be addressed:

1) Market analysis

What is the potential market size for your product today and the future?

What are your competitors' products in China? How well do they sell?

What market segments are your competitors targeting, and how do they market their products?

What advantages do your products have compared to your competitors?

How can you do better to compete with your competitors?

Will your product be subject to the price ceiling?

What is the market segment for your product?

What are your short and long term goals in China?

2) Regulatory issues

What are the regulatory requirements for your products?

What is the cost of approval? How long does it take?

Are there any regulatory limitations for your products?

3) Partnerships

How does your product fit in to their product line?

How are they going to market your products?

Do you have know-how or trade secrecy to be protected? If so, how?

4) Doing it yourself

What benefits can the local cities offer to you?

How does the location benefit your business operation?

How does the location help you reach out your to buyers/consumers?

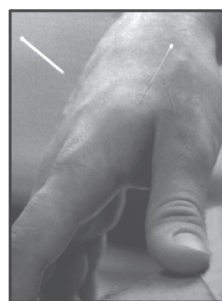
How did other foreign firms do in that place?

Travel to China to meet and visit your partners regularly to promote mutual understanding. Remember that, with partners, bigger is not always better. Large domestic firms may have hundreds products in hand, while small firms might put up more effort in marketing your products. Knowing your partner will help you understand how well your product will do in China and align your expectations as well.

Just as in other countries, doing business in China will not be an easy task. But the fact that many foreign joint venture pharmaceutical companies in China have taken up more market share is proof that China's healthcare market is ready for good players with good products. It is certainly time to get a footing in this emerging market.

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