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Responding To Challenges In The Chinese Healthcare Market

Part III: Medical Insurance

[This is the third in a three-part series]

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June 2023

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The Chinese healthcare sector was once extremely attractive to multinationals who were able to sell their patented drugs and medical devices to a captive Chinese market. But those days have long gone as China sets out on a long-term plan to tackle spiralling healthcare costs and make the sector more efficient.

Not only has the unit cost of drugs and medical devices risen sharply – with the result that every patient in the country is costing the government more and more - but at the same time demand for these products is soaring as consumers reap the benefits of having access to innovative new drugs and medical devices.

In a series of articles we have been looking at the specific ways in which the government has tackled this huge issue and how multinationals need to respond. We began our series with a look at the huge impact of the Volume Based Procurement policy, while in our second article we reported on how local sourcing has become a central focus of the government and is forcing multinationals to reconsider their production strategies.

In this final article we assess the impact of some specific new medical insurance schemes which are being piloted across the country, and what they mean for overseas players.

Preventing over diagnosis

DRG (Disease Related Groups) and DIP (Diagnosis Intervention Packet) are two new forms of medical insurance payments in relation to drugs, medical devices, diagnosis and treatment procedures. Essentially, they have been introduced to help prevent over diagnosis and over treatment, and hence bring down healthcare costs.

DRG is a payment based on a calculation by clinicians into what will be the average expense relating to a specific medical condition. This calculation considers factors such as the patient's age, gender, and seriousness of operation etc.

Unlike the DRG, the DIP calculation is not based on the view of a clinician, but is instead based on historical data kept by hospitals. In short, the DIP uses and exploits this database in order to work out a reasonable price for a particular medical procedure.

At the moment it is worth stressing that both systems are only being piloted in various cities across the country, especially in larger cities with better databases and more experience in new policy implementation.

Implementation

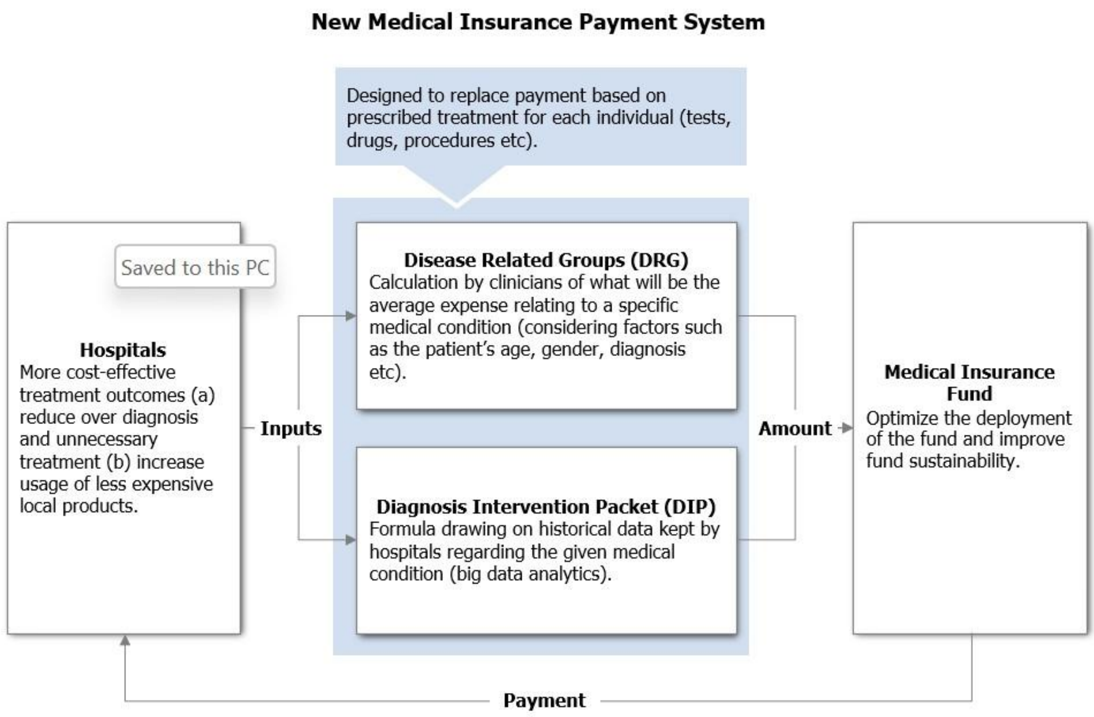
At the moment implementation of these new systems is proving hard for a number of reasons. Indeed, at only about a third of the pilot cities have been currently labelled 'model cities' that are demonstrating satisfactory DRG/DIP implementation.

One reason is that many hospitals do not have electronic patient records. Another reason is that these new systems rely heavily on accurate calculations by doctors, but there are concerns that clinicians are not yet well enough trained in them. And finally, there is also the fact that the DRG system has been developed from western countries, so there is a need to establish treatment pathways and payments for traditional Chinese medicine treatments.

Despite these challenges the indications are that the government will eventually implement these policies nationwide, albeit perhaps with some modifications.

The experience with VBP is certainly a guide here. Despite initial concerns that it could not be implemented nationally due to the huge impact on all players in the supply chain, VBP has now become a national policy as it is increasingly rolled-out.

Chart #1



Sources: InterChina Analysis.

How multinationals should respond

So, what do these insurance schemes actually mean in practice for multinationals? To recap, both schemes relate to existing drugs and medical devices that are used for current treatments and diagnosis. New products will not come under the schemes for at least a few years because the payments system is based on products that already exist in the marketplace.

As such there is a great incentive for multinationals to focus on new, innovative products while their patents are still live. The filing of patents of innovative medical devices, which last for five years under the National Intellectual Property Administration, is also strongly supported by the government. As a result, multinationals have increasingly started to register China patents in recent years due to this highly attractive policy support.

Home-grown impact

The fact that new products are not covered by DRG is not lost on Chinese home-grown players which are also at the forefront of developing highly technical and innovative products in areas such as implants and medical interventions. This activity has also spawned significant investor interest at home and overseas. In fact, this represents a further opportunity for multinationals to strike up strategic joint ventures with Chinese players, or even acquire them.

Responding to the challenges: A summary

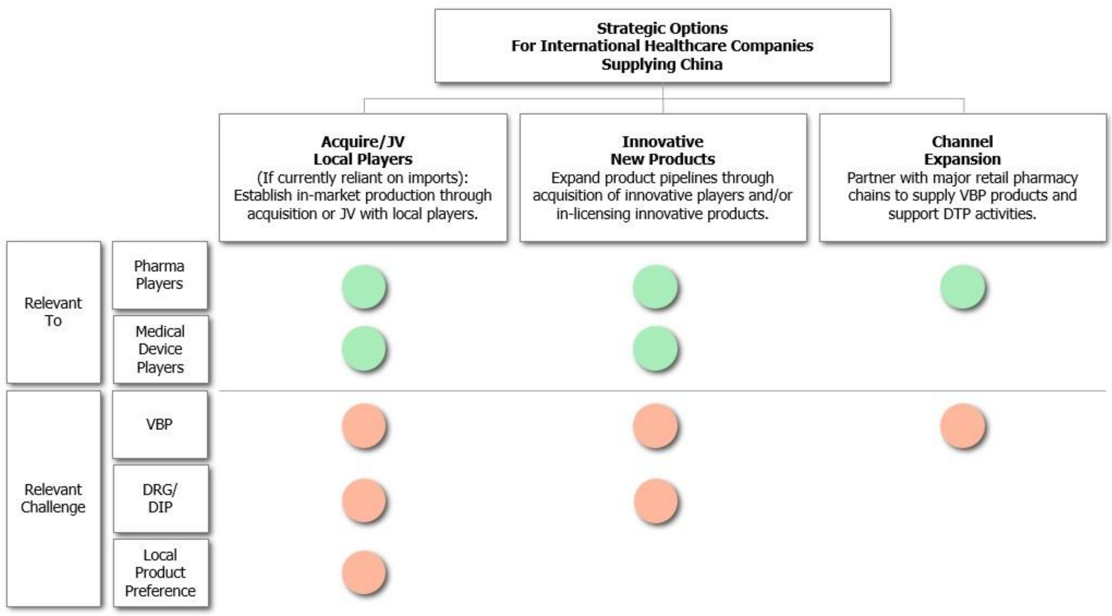
In these three articles we have looked at how multinationals should be responding to a number of significant new policy measures in the healthcare sector. The combination of VBP policies, local preference policies, and new medical insurance schemes, has created a challenging and complex landscape, but also one that still has plenty of opportunity.

For multinationals the key focus has to be on locally sourced innovation and expanding product pipelines in order to override these new challenges. And with the Chinese market itself abuzz with innovation across the sector, it could be that the M&A route is the best way for many multinationals to achieve these goals.

Meanwhile, in terms of the pharma market specifically, it could be that players consider partnering with major retail pharmacies to take advantage of the huge move towards Direct to Patient products.

Chart #2

Summary Of Strategic Options



Sources: InterChina Analysis.

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Rick Woo is a Principal in InterChina's Strategy Practice. He has over 20 years experience in pharmaceutical and med devices sales in China and APAC, as well as rich strategic project management experience in Pharmaceuticals & Medical Devices sector.

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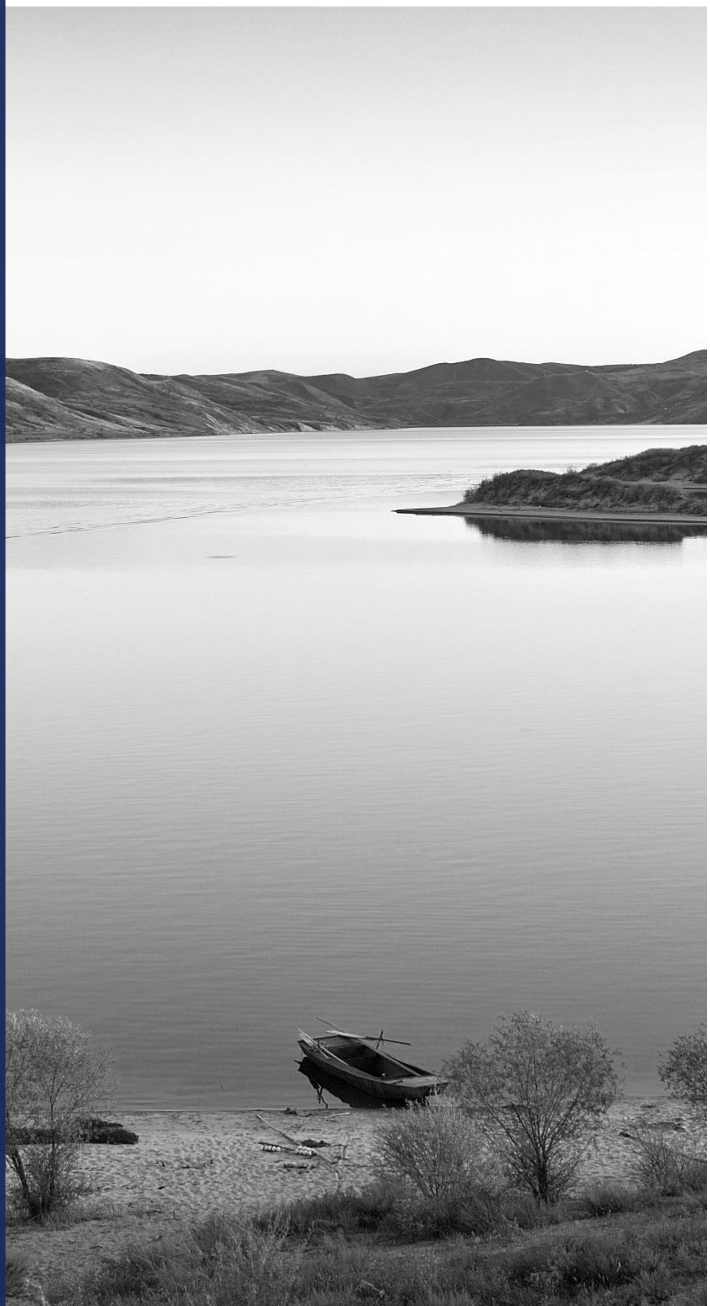

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