InterChina

英特华

INTERCHINA INSIGHT

CHINA HEALTHCARE **CHANNEL CASCADE** HERALDED BY POLICIES

Retail and e-commerce channels will become increasingly important for healthcare MNCs operating in China.

Authors

Rick Woo, Principal
Emily Zhang, Consultant

AUGUST 2020

www.InterChinaConsulting.com
www.InterChinaPartners.com

Strategy I Corporate Finance

Due to drug cost containment policies, retail and e-commerce channels will become increasingly important for healthcare multinationals operating in China, says Rick Woo.

Until recently patients in China had little reason to deviate from the conventional prescription and dispensing journey. Where public hospital doctors prescribed, in-hospital pharmacies then dispensed. However a number of regulatory, commercial and technical dynamics are now starting to change the status quo, creating the need for a multi-channel environment to provide patients with more choice. And it is these alternative channels where multinational drug companies are increasingly focusing their attention to grow sales of their branded drugs.

As we discuss in this report, regulatory control over public hospitals is tightening, whether through centralizing drug purchasing (see "4+7 Central Purchase Scheme" below) or systemizing drug prescription (see "Diagnosis Related Groups" below) to reduce costs. As such the potential for off-patent branded drugs through in-hospital pharmacies is being squeezed.

However, public hospital doctors still recognize the value of a wider range of drugs, and are still recommending and prescribing them. Where these drugs are not covered by public health insurance and dispensed by in-hospital pharmacies, patients are instead turning to out of hospital prescription via retail pharmacies or e-pharmacies. This is especially the case if they are among the growing number of people covered by the boom in commercial health insurance.

Public hospitals still dominant

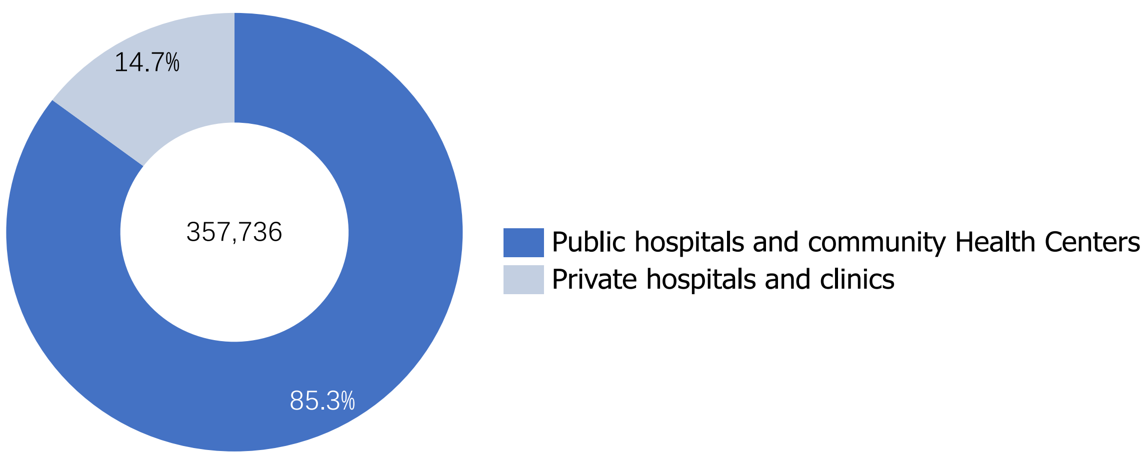
The Chinese healthcare industry remains heavily based around its public hospitals. Indeed, according to the 2019 Health and Hospital Statistics Report, public hospitals accounted for more than 85% of healthcare services in terms of patient numbers in China.

As such leading players across both the pharmaceutical and medical devices industries continue to be highly focused on targeting this sector, as patient drug and medical device use is often decided by decision-makers in public hospitals. So engaging with physicians, pharmacists, equipment and device purchasers, and hospital directors is important. However, despite the dominance of the public hospital market, sales growth in the prescription drugs sector has slowed in recent years from 7.5% in 2015 to 4.5% in 20191, a trend that is expected to continue due to increasing central control over drug prices, purchase levels, and healthcare expenses. This central control means that hospitals are looking to source lower priced, locally sourced generic drugs rather than off-patent branded drugs.

This means that multinationals - and especially pharmaceutical companies which rely on significant sales from off-patent brand drugs - are now facing a major challenge to their market share and margins in China. Indeed we have already started seeing these multinationals adopting far more multi-channel strategies with, in particular, attempts to gain greater market share in the retail pharmacy and e-commerce markets.

Chart #1

No. of Out-Patient (10,000)



Source: 2019 Health and Hospital Statistics Report

Turning private?

Faced with the loss of market share multinationals either drop their prices significantly, which is unlikely, or more realistically have to look at other avenues such as increasing their share in the private hospital market.

However although drug sales growth in the private hospital market is stronger than in the public hospital market, growth slowed from 10.1% to 7.9% between 2015 and 20191. Furthermore there is also little sign of public hospitals losing any market share to private hospitals as most patients still prefer to seek treatment within leading hospitals in the public sector.

Retail pharmacies

Another avenue multinationals can explore instead is the retail pharmacy market, and here they can definitely see great potential. This market has seen strong growth of around 7.5 to 8%1 in recent years, in part driven by the fact that retail pharmacies operate under reimbursement licenses which means that patients get reimbursed for their drugs through insurance.

At the moment we are seeing particularly strong investment in the number of direct-to-patient pharmacies that provide professional disease management and services to patients. Indeed, continued strong growth is expected in the prescription drugs market in the retail channel, especially in areas such as cardiovascular disease and diabetes.

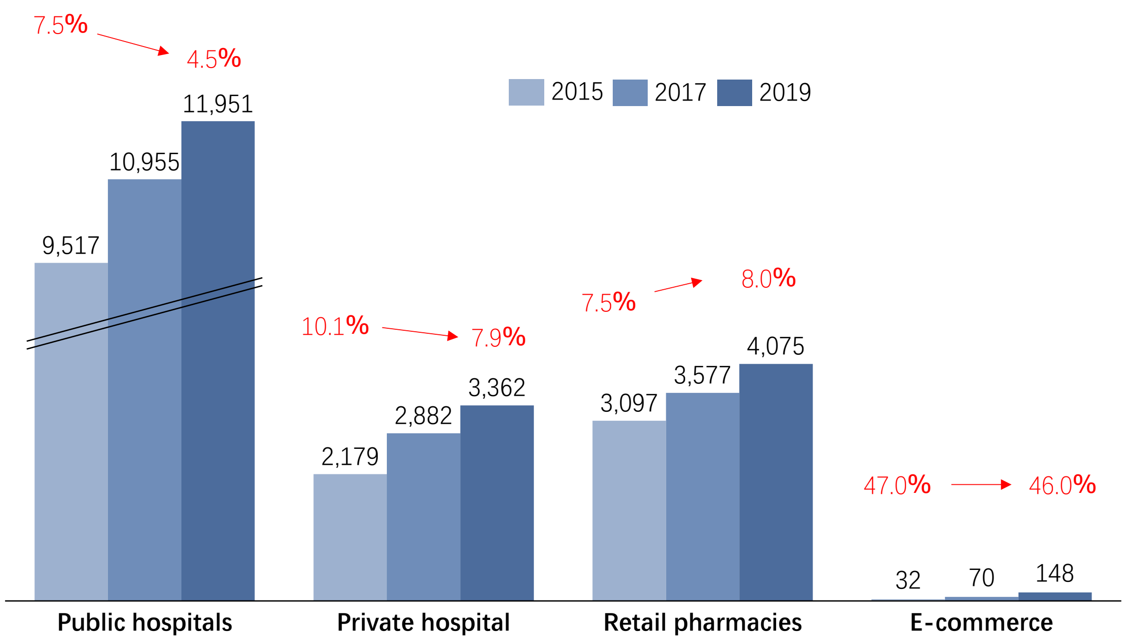
Within retail pharmacies the attraction of well-known branded drugs has far greater traction too. Whereas in hospitals patients are not given the choice of a foreign brand as a result of the central purchase policy, in a pharmacy they do have a choice and can be prepared to spend more.

However foreign companies have to be careful how they pitch their prices, especially if patients are aware how much generic drugs cost in hospitals.

Chart #2

Pharmaceuticals sales by and growth rate of different channel

(RMB 100 mn)



Source: Menet - Sales of prescription drugs by channels

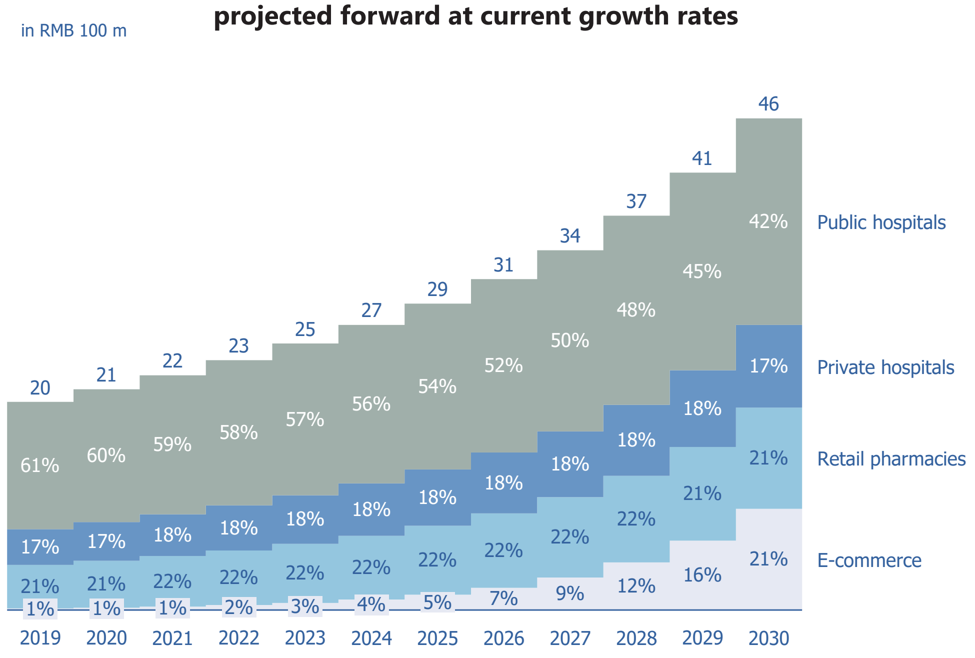
E-commerce

The fast-growing e-commerce sector also offers strong opportunities for multinationals. Due to concerns over patient safety the government has been careful not to open up the market too quickly, and the criteria and requirements for approval of online prescription drug licenses remains stringent.

However the potential of the channel is promising and it is growing rapidly. All the major retail pharmacy chains are now entering this market and building their online platforms, while heavyweight e-commerce players such as JD.com and Alibaba are also investing in the market. Looking ahead, there will undoubtedly be increasing demand from patients for more convenience and accessibility to drugs, and we expect the market to grow exponentially.

Chart #3

Channel distribution of pharma sales in China projected forward at current growth rates



Source: Menet, InterChina projection.

Multi Channel Policy Drives

4+7 Central Purchase Scheme

4+7 Central Purchase Scheme
One of the most notable recent health reforms has been the National Drug Centralized Procurement Scheme, more commonly known as the 4+7 scheme, which aims to cut drug costs and consolidate procurement via a centralized system of quality control of public hospitals. Its title reflects how the scheme was started in four municipalities and seven provincial cities.

The first round of 4+7 central purchase was competed at the end of 2018 and involved 25 drugs with total drug expenditure cut by 44%. Notably, only two of the 25 drug contracts were awarded to foreign company brands, and a number of multinationals have seen drug sales fall heavily in China as a result. Moves to expand the 4+7 scheme to all provinces is scheduled for later this year.

A similar pilot project for nine provinces was initiated in medical devices last year for products such as intraocular lenses, artificial joints, orthopedic implants, pacemakers, cardiac valves, and stents. However in contrast to pharmaceuticals, setting a standard for medical devices in terms of specification and quality for fair evaluation is not easy, which makes the implementation of medical device central purchasing more difficult.
As such the impact may be less obvious in the near future, but the big question for multinationals is whether medical device central purchase will ultimately resemble that of the pharmaceutical market.

Diagnosis Related Groups
Last year the National Healthcare Security Administration announced plans to conduct pilot tests in 30 cities of Diagnosis Related Groups (DRGs), a way of classifying patients with similar clinical symptoms and resource costs based on their age, gender, length of stay and clinical diagnosis. Medical fees and insurance payments are therefore based on DRG classification rather than on specific patients.

The idea is to prevent over diagnosis and prescription, so doctors prescribe only essential drugs and diagnostic tests and then perhaps recommend other drugs which patients go on to buy from retail pharmacies. The policy has already been shown to significantly reduce the use of more expensive drugs, and full nationwide implementation of DRGs is expected in 2021.

Commercial Health Insurance
An increasing number of patients now fall under commercial insurance schemes in China and one forecast suggests that up to 40 million people could be potential buyers of commercial health insurance by 2020. Commercial health-related premiums amounted to about RMB240 billion in 2015 and may increase to RMB1,100 billion by 2020.

Consumers seeking commercial health insurance are also more likely to be able to afford branded drugs compared to local generics. As branded drugs are unavailable in public hospitals they will purchase them in retail pharmacies or via e-commerce channels and then be reimbursed through insurance policies. They will also be prepared to pay more to buy imported medical devices rather than rely on Chinese-made products.

As such, the growth of commercial health insurance will be an important driver of revenue streams for multinationals.

Implementing digitization

With the healthcare market becoming ever more digitized, working out the correct digital strategy becomes crucial for multinationals. Such trends have only been accentuated by the Covid-19 pandemic which has been a strong catalyst in speeding up the digitization of global health systems. Against this backdrop, and as a result of the fall in profit margins due to drug cost containment policies, e-marketing and e-selling are becoming increasingly important functions for any pharmaceutical company operating in China. Also of note, this digitization drive isn't just restricted to the pharmaceutical industry and we are also seeing an increasing number of digitalized medical devices applications too.

Working with third parties
Some multinationals have now built up their own digital platforms, while most are very advanced in applying digital tools such as CRM for marketing and online selling to increase return on investment. However many multinationals do not yet have their own complete e-system in China so are using a combination of digitalization service providers and cloud companies to meet this increasing demand, as the graphic below shows. The critical success factors for such partnerships are to set clear objectives, plot well-defined outcomes, and constantly monitor performance.

Chart #3

Pharmaceutical digitalization: Facing the multi-billion drug market

Source: Article from 动脉网

Retail pharmacies and e-commerce

As we have already remarked, the retail pharmacy and e-commerce markets are likely to be areas of strong growth for multinationals with off-patent drugs in the future. But due to the immense size of the retail pharmacy market in China – there are almost 500,000 pharmacies - large multinational pharmaceuticals shifting their business models to the retail market will face big challenges in managing the channel, and in the development and implementation of their strategies.

Selecting a strong national distributor with their own retail pharmacies is preferable in order to facilitate delivery and stock. Besides, from the sales process point of view, getting real time sales and stock data is critical and is only really possible through a digital platform of all retail pharmacies.

Internet hospitals

The retail market is also likely to benefit from the long-term development of internet hospitals which are the online platform of existing hospitals. In 2018 more than 150 internet hospitals were approved, showing the future growth potential of this market. Internet hospitals are used by out-patients with stable conditions. Patients get a doctor's prescription and then buy the drug from retail or online pharmacies, without the need to wait for a consultation and getting the drug in hospitals. Online communication might also be held with retail pharmacists and this benefits multinational suppliers of branded drugs as instead of the patient going to hospital and only being offered a local drug product they have the option of buying the branded drug.

Service providers

In response to these trends a number of Chinese companies have emerged to help pharmaceutical and medical device players establish and develop their businesses in the retail and e-commerce channels. One example is Beijing-based Lefthand Doctor which, as a digital service provider, helps link patients to relevant doctors and also provides solutions to pharmaceutical and medical device players in patient database management and product loyalty.

Another example is Beheal Pharmaceuticals, a specialist in retail prescription monitoring systems, which has built partnerships with a number of retail pharmacy chains and is helping several international pharmaceutical companies.

Serving new channels

As we have shown in this report, alternative channels are increasingly exerting influence over patients. For instance direct-to-patient retail pharmacies, which provide consultative health services, influence patients in terms of requesting certain drugs from their doctors, or makes them switch brands when on repeat prescriptions.

Internet hospitals, which patients turn to for mild conditions, are able to provide e-prescriptions fulfilled by e-pharmacies. And then there are also the private hospitals, which may or may not have their own in-hospital pharmacies, but which recommend and prescribe a wider range of drugs.

Looking ahead, these alternative channels will become increasingly important for multinational drug companies which will need to figure out how best to cover and serve them. Furthermore, the growth of such channels has only been accentuated by the Covid-19 pandemic, with pharma companies in particular accelerating their e-marketing and e-selling operations as they move away from basing their operations around hospitals.

Author

Rick Woo
Principal, Shanghai
rick.woo@interchinaconsulting.com

Rick Woo is the Principal with InterChina, based in our Shanghai office. Prior to InterChina, he looks back on over 25 years of experience in China's and APAC's healthcare industry, holding previous positions as the GM of Amgen China and head of sales of Oncology Business Unit with Novartis China.

Contributor

Emily Zhang
Consultant
Shanghai

About InterChina

InterChina is the leading advisory firm specialized in China. Our multinational and Chinese clients choose to work with us because we provide real understanding, deliver practical results, and know how to get things done. We are a partner led firm, and distinguish ourselves by the deep level of engagement partners have in client projects.

InterChina
英特华

InterChina

Exclusive China Partner of CLEARWATER INTERNATIONAL

CONTACT US

+ 86 21 6341 0699

interchina@interchinaconsulting.com

Suite 1201, 100 Bund Square
100 South Zhongshan Road
Shanghai 200010, P. R. China

www.InterChinaConsulting.com
www.InterChinaPartners.com

INTERCHINA LINKEDIN

STRATEGY WECHAT

CORPORATE FINANCE WECHAT