

2023 OUTLOOK OF CHINA
HEALTHCARE INDUSTRY:
REMAINING PRAGMATIC
WHILE MOVING UP
THE VALUE CHAIN



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PREFACE

As we enter 2023, China surprised the world with a swift and decisive shift in COVID policy, demonstrating the country's ability to be flexible and pragmatic in its decision-making. In contrast to Russia's persistent adherence to ideologies, China demonstrated its willingness to pivot quickly when necessary.

The 14th Five-Year Plan at the 20th National Congress last November emphasized words like "innovation," "science and technology," and "international," setting the foundation for a long-term scheme to construct a new global order. China's ambition to lead this new order by dominating critical sciences and technologies sectors, rather than serving as outsourced labor for foreign companies, marks a shift towards targeting a higher-value position in global industry.

The Life Sciences and Healthcare (LSHC) sector, which relies heavily on innovative sciences and technologies, is crucial to this plan. Over the last five years, it has undergone remarkable transformations, with updated technologies, healthcare reforms, and an aging population presenting new challenges and opportunities.

In this white paper, we will explore the current state of China's LSHC industry, the impact of recent policy changes, the reactions of MNCs and domestic companies, and what the future may hold.

ENVIRONMENT OF 2023:

Environment 1: China's healthcare demand will sharply increase due to post-COVID reopening and an aging population, but this surge may strain the country's healthcare system and HCPs in the long term.

As China continues to reopen and its population ages, a surge in healthcare demand is expected. Hospitals are already reporting an increase in visits for chronic conditions such as diabetes. While the country's reopening has brought a sense of normalcy, there are growing concerns about the sustainability of China's healthcare system in the long term. These concerns are not unique to China, as healthcare systems around the world are feeling the strain. The NHS waiting list in England has grown by more than 60%, and in Canada,

patients are experiencing all-time high wait times for treatment. Even in highly efficient healthcare systems such as Singapore's, patients are facing long waits. In the U.S., despite its exceptional spending on the healthcare system, the current record-high hospital occupancy rates indicate that no one is immune to the challenges of this situation.

Given China's much larger population and aging demographic, the country is particularly vulnerable to these challenges. With a doctor-patient ratio of 60% of the U.S., China will need to work hard to meet the healthcare needs of its citizens, especially as demand continues to rise. The risk of falling into a chaotic situation is very real, and this situation may be exacerbated by controlled funding and exhausted healthcare professionals who have been working tirelessly under COVID policies and been promised incentives that may never be delivered.

The aging population and ongoing COVID outbreaks are the immediate causes of the additional pressure on China's healthcare system and are unlikely to dissipate soon. Therefore, managing healthcare professionals' burnout has become a priority for hospital administrators, given that their skills and efficiency depend on their physical and mental well-being.

Environment 2: Further price cuts are expected in future rounds of negotiations with the NHSA due to stagnant growth in the Medical Insurance Fund (MIF), leading to continued competition among large companies.

The MIF faces financial stress; sustaining its current size will be a major challenge.

In recent years, the MIF's balance sheet has been stretched. The NHSA reports a 600% increase in monthly premiums for each enrollee from 2011-2022, yet it still faces many obstacles. As of 2021, the overall surplus ratio of the MIF is only 4.4%, and many provinces are reporting deficits.

The burden is increased by the aging population and shrinking workforce. In 2023, China's official statistics showed negative population growth for the first time in 61 years, with the over 60s accounting for 20% of the population and the over 65s for 15%. With an elderly population of 209 million and annual GDP growth of only 3% in 2022, well behind the official goal of 5.5%, this historic demographic turnaround will increase medical costs.

The draconian COVID testing regime, which involves many PCR tests, is also adding to the burden, with the MIF reportedly covering around 80% of the testing fees.

China's limited funding for reimbursement means that companies will face continuous price cuts and competition to secure coverage.

China's drug reimbursement policy has placed immense pressure on pharmaceutical companies, as they face continuous price cuts and fierce competition to secure coverage of their products. The NHA has been negotiating with foreign and domestic companies since 2018 to lower prices for innovative drugs in exchange for their inclusion in the National Reimbursement Drug List (NRDL). This policy has resulted in deep price cuts, with an average reduction of 60.1% for the 121 innovative drugs included in the NRDL in 2022. For instance, Roche's Evrysdi® (risdiplam), which was approved by the FDA in 2020 for treating Spinal Muscular Atrophy (SMA), paid a 94% discount for enlisting into NRDL.

These steep price cuts are expected to persist, favoring newer drugs rather than older ones. Another price reduction mechanism is the Value-Based Purchasing (VBP) scheme, which targets less innovative drugs and medical devices (and now aims to expand to high-value medical devices) leading to an average price reduction of nearly 80% and a maximum reduction of 97.9% in 2022.

As a result of these policy changes, pharmaceutical and medical device companies in China will continue to face fierce competition and pricing pressures, with smaller firms potentially facing a higher insolvency risk.

Innovative payments, such as Commercial Health Insurance (CHI), will become an integral part of China healthcare funding, supplementing coverage beyond Social Health Insurance.

In recent years, with growing government support, CHI has emerged to supplement existing Social Health Insurance (SHI), increasing access to healthcare and innovative medicine, improving overall affordability, and easing the pressure on the Medical Insurance Fund. In 2015, City CHI (also as known as Huimin) was rolled out, and it was expanded in 2020 to reduce the financial burden on enrollees due to severe and chronic diseases.

Huimin is run on a public-private partnership model

and operates at the city level, where the government supervises the operation with private insurers. However, Huimin faces the challenge of operational unsustainability, with below 5% enrollment, which is not enough to cover the enrollees. Nevertheless, with continuous support from local authorities and maturity of the claim system over time, we expect enrollment to increase.

As China's population ages and demand for healthcare services increases, the government will further develop and expand the CHI to provide broader access and reduce the government's burden.

RESPONSES OF PLAYERS:

MNC Responses: MNCs are adapting to China's evolving healthcare landscape with diversified products and strategic localization to stay competitive

China's double-digit economic growth ended in 2010. In 2011, it slowed to 9.2%, and reduced further in subsequent years, marking the end of the golden age of Chinese economic prosperity. Since 2020, China's economic environment has become more inward-looking due to President Xi's "Dual Circulation" macroeconomic policy. This policy separates domestic and global markets and calls for more domestic innovation and self-reliance, moving away from the previous era of rapid growth and openness to foreign investment. LSHC has felt the effects of this trend, as domestic products are often given preferential treatment over foreign ones. This has led to increased competition from domestic companies and has resulted in lower profitability and shorter profit periods for MNCs, particularly those focusing on cancer and diabetes.

In response, MNCs have brought in diversified innovative products and localized their operations, as a commitment to China.

For example, one of our European clients is partnering with a domestic cloud-based health start-up to build an online chronic disease diagnosis and education platform. This client is also entering the online health innovation ecosystem in China to explore the metaverse as digital health's next frontier. Another European pharma client is doubling down in China by integrating its pharma, Life Science, and electronic technology activities.

One MedTech client has signed a strategic partnership agreement with a regional High-Tech Industrial

Development Zone to contribute manufacturing and R&D functions for orthopedic surgery products.

Localizing offers benefits on many levels. Economically, it can reduce associated labor, distribution, and custom costs. At a policy level, locally-made products may qualify more readily for government procurement tenders and approval submissions. Localization can also address the specific needs of China's healthcare system, particularly in MedTech, as doctors demand more efficient medical equipment to accommodate the large patient inflow. By catering to the unique needs of the Chinese market, MNCs are positioning themselves for success in the evolving healthcare landscape of China.

MNCs that adapt to China's evolution through localization are well-positioned to thrive in market and continue to provide solutions to the growing healthcare needs of China's population.

Domestic Biotech Response: As the healthcare capital spree cools, domestic biotech and pharma will conserve cash and seek exit plans.

Over the past decade, the biotech industry has made significant progress thanks to capital investment. Innovative therapies such as gene therapies, immunotherapies, and innovative medicines for rare diseases have shown promise in treating cancers, oncology, and rare diseases. As a result, biotech stocks have offered high returns.

China has also been paying attention to the potential of the biotech industry. From 2016 to 2021, the market value of publicly listed biopharma companies from China across major listings has risen from \$3 billion to \$380 billion. In fact, out of the 10 top initial public offerings (IPOs) from 2018 to 2020 in biotech, 7 originated in China.

However, in 2022, regulatory scrutiny, government negotiations, and inflationary pressures are making it challenging for biotech companies to secure funding. This is particularly difficult for firms that were used to burning cash for progress, including Chinese biotech. The average valuation of biotech companies in Hong Kong fell 30% in 2022, and more than three-quarters are trading below their listing price. The pace of new listings also slowed down, from nine in 2021 to five in 2022.

As the healthcare capital spree cools down, China's domestic biotech and pharma industry is struggling for profitability, particularly due to price cuts implemented by the National Healthcare Security Administration that disrupted their business plans.

Moreover, China's domestic biotech and pharma industry is struggling to be profitable, particularly due to price cuts implemented by the National Healthcare Security Administration that have disrupted their business plans. Despite the early listings of superstar biotech startups like BeiGene, Zai Lab, and RemeGen, none of the 40 early-stage companies that floated in Hong Kong since 2018 are currently profitable.

Many Chinese biotechs have filed U.S. new drug applications based on China-only data or studies with limited U.S. patient enrollment. However, recent rejections by the FDA have prompted a reconsideration of this approach. Additionally, increased geopolitical tensions may create further trouble. For example, continuing Trump-era tariffs on the biotech sector and the potential delisting of three major biotechs from the U.S. Securities and Exchange Commission (SEC) are major concerns.

Small biotechs have had a particularly challenging year due to COVID-19 policies and investment drains. Some of our local clients sought measures to divest or out-license to large pharma to address their current funding issues. However, despite these temporary obstacles, there are still opportunities for biotech companies in China, particularly in areas such as gene editing, immunotherapy and AI-powered drug discovery.

Looking ahead to 2023, while cash flow and the situation may improve, ongoing price cuts and volume-based procurement remain major challenges for the domestic market. However, those who planned early and collaborated well are likely to succeed. For example, one of our Guangdong-based clients has planned for sustainability and has signed an out-licensing agreement with a U.S. Pharma.

With strategic planning, collaboration, and a focus on innovation, some Chinese biotech companies will be able to overcome these challenges and become successful players in the global biotech market.

CONCLUSION

In 2023, China's healthcare market demand is expected to be driven by the reopening and aging population. With continued healthcare reforms and integration of private payers, more channels for innovative therapies are expected to be created.

However, the challenges of limited public funding and pressure from policymakers suggest a limited profitability for both MNCs and local companies in the domestic market. Companies must plan for the long-term value of the Chinese market and consider alternatives. For instance, one MNC, even with a price cut of 98% in a lead product compared to the U.S., continues to make significant revenues based on the scale of the Chinese market.

For domestic biotech companies, overseas markets represent huge potential but can be increasingly difficult without a well-established strategy and reliable partnerships.

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