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What McKinsey brings to the table is a globalized view combined with deep local expertise.

02.08.2019

Tags: China, McKinsey, Consulting

Gaobo Zhou is Partner and co-leader of the Healthcare Practice in China and has been with McKinsey for over a decade, Gaobo discusses the changes occurring within the complex and fast-paced Chinese healthcare landscape over the past few years and how McKinsey supports industry stakeholders in China to help them pursue growth, performance and innovation in a dynamic market place.

Gaobo, having been working with the Chinese healthcare market for over a decade now, how have the recent market reforms – in terms of the speed and the type of policies rolled out, for instance – in China matched your expectations?

Undoubtedly, they have exceeded my expectations just as I am sure they have exceeded many industry veterans' expectations as well. In the early 2010s when China's healthcare reform had just begun, we were already very impressed with the speed at which reimbursement coverage was being rolled out, for instance. However, we also thought there remained areas in need of improvement. In the past three to four years, the speed at which the National Medical Products Administrations (NMPA) have unrolled their reform initiatives has further exceeded my expectations.

The major impact of the reforms has been the acceleration in the approval, launch and reimbursement of new and innovative drugs while healthcare expenditure shifts away from more

mature products. This is positive for the overall healthcare ecosystem but it is important to fully understand the potential opportunities and challenges associated with these changes and the pace of these changes.

How prepared in general are industry players in terms of reacting and responding to these regulatory changes?

Industry players have been exceptional at responding to policies that have been announced. When there is a new policy, companies immediately go into overdrive examining different options and solutions they can adopt; potential outcomes they need to consider; risks they should identify, and so on.

However, where industry is lacking is a more forward-looking perspective in terms of understanding or anticipating the future development or unfolding of announced policies. There needs to be a more thoughtful examination and understanding of potential future scenarios based on current government priorities combined with input from different stakeholders. Companies should define future scenarios to guide their strategic thinking and planning. This forward-looking mentality will ultimately differentiate the winners from the rest of the pack.

Some of the policies have remained in the spotlight, including the 4+7 volume-based purchasing policy, the generic quality consistency evaluation (GQCE) and the updates to the National Reimbursement Drug List (NRDL). Could you highlight other reforms that might have slipped under the radar but are equally important to the market?

I would say the public hospital reform has also been a tremendous driver for improving the delivery of care to patients, as well as promoting more efficient usage of the existing healthcare infrastructure and resources. For example, tiered diagnosis and treatment was introduced to patients with less serious conditions to visit lower-tier hospitals, which promotes more efficient utilization across the different tiers of hospitals. In the meantime, however, this also brings a major challenge, which is the need to build up the capabilities of doctors in lower-tier hospitals as quickly as possible. Already, pharma companies are looking to broaden their reach across China by training medical and sales reps to engage with this group of doctors. This not only benefits pharma companies in terms of broadening their market penetration but also enhances the capability of doctors across China. Other hospital reform policies such as physician multi-site practice and DRG

based payment may still be in the early phase of implementation, but will also have lasting impact to the China healthcare system.

Another area I find extremely interesting from a policy standpoint is digital health. It is increasingly clear that China is committed to laying out policy frameworks to provide the industry with guidance in this space. We see China as a fertile ground for digital health innovation. Pharma companies, digital giants like Alibaba and Tencent, and other emerging innovative companies are all seeking new ways and models to deliver digital healthcare to patients.

What are some of the biggest misconceptions of the China market within the industry globally that still persist today?

Without calling them misconceptions, I think there are a few prevailing interpretations of the China market. One of them is the predictability of China. There still remains a mentality that business in China is predictable – as it has been for the past couple of decades – and sometimes companies or their HQs try to impose a five-year forecast or strategy and hold the local teams responsible for that. In reality, things are changing extremely quickly in China. Companies need to understand the importance of having some level of flexibility built into internal KPIs and projections.

In the digital space, we are seeing expectations about the adoption of new digital technologies and models. For instance, companies should not expect that they can launch an app one day and quickly attract a significant number of users, simply because China is big. In reality, the digital landscape in China is extremely complex and scale is not a given. This is why many digital collaborations between pharma companies and tech giants often do not go beyond the signing of an MOU. The importance of pinpointing a specific unmet patient need, of building something to address that specific need through a positive user experience, and finding the partner with a win-win value proposition, should not be underestimated. At the end of the day, companies need to deliver a solution that is truly beneficial to patients and healthcare providers, and that can be much more difficult than anticipated.

We hear a lot about ‘China exceptionalism’ as well and in many ways, the Chinese market is unlike any other. How applicable are the lessons learned by companies in China to global markets?

Learning from China can be very beneficial for global markets. Firstly, the diversity within China means that first-tier cities like Shanghai and Beijing often resemble mature, developed markets, while inner and western provinces may resemble underdeveloped and emerging markets. They reflect different levels of physician capabilities, different unmet needs and different levels of patient affordability and accessibility. How companies deal with payers, physicians and patients across these different markets can definitely be mirrored in other countries.

Back to digital innovation, China will potentially be the leader in digital health so the way the digital health space develops in China will probably have broad implications across the world. Already, companies are starting to think about how China can become a beacon of digital innovation for other markets. When we talk about digital health, the focus does not need to be on the digital technology per se. We are also talking about better diagnostics, better delivery of care, cross-ecosystem partnerships and so on. These are all elements that can be applied and replicated in other countries.

The rising importance of China to global pharma companies is indisputable. How will this affect the internal organization of these companies, which have for the large part been HQed in Europe and the U.S.. and have therefore historically been quite oriented towards the U.S.. and European markets?

The percentage of China sales out of global sales has increased significantly over the years. Where it was in the mid-single digits five years ago, for many MNCs, the figure is now in the mid-teens with some even reaching over 20 percent. When looking at contribution to growth, that figure is even higher.

It is undeniable that the importance of China has grown over the years and we see this being reflected in the status that China enjoys within companies' overall global strategy and the voice that China has in global decisions such as R&D and pipeline development. There are also organizational changes; in many cases, China has been elevated to report directly to the CEO's office or in combination with other key emerging markets. Furthermore, we are starting to see China managers being promoted to very senior international roles, with notable examples coming from AstraZeneca and Novartis, with the former China GMs now running international markets. In summary, China is now becoming a much more important part of the global organization.

However, despite its size and value, China still does not resemble a mature market. Whether we look at ways of working, culture, process design and interactions with global functions, there

remain a lot of inefficiencies. At the same time, given importance of the China market, many companies are thinking about how to give China the independence and the decision-making power that it demands whilst still maintaining the affiliate's ability to collaborate and coordinate across the global organization.

Will it become more essential for pharma CEOs or their management team to have China experience?

Certainly, China experience will become increasingly essential for top pharma executives. For example, Eli Lilly's current CEO previously managed the China affiliate. However, this is not an easy transition and will take some time.

In the near term, what is important and feasible is for current CEOs and executive teams to gain that China experience and exposure by visiting China. This does not mean coming once a year to conduct an annual business review but by thoughtfully and strategically planning a series of meetings with the relevant stakeholders. This includes identifying the specific stakeholders that specific executives should meet at provincial, municipal and local levels; identifying the relevant conferences to attend; identifying the messages that need to be delivered to each stakeholder and on each platform – and so on. These are very micro decisions. I have seen some companies being extremely successful in orchestrating these types of high-level China visits and having productive dialogues.

Coming to McKinsey specifically, as the leader in consultancy within the healthcare space in China, what have been McKinsey's contributions during this transformative period of the Chinese healthcare ecosystem?

We have been advising many companies on their strategy in responding to external environmental changes including how to drive growth, expand their organization, strengthen R&D, adopt innovative commercial models, foster partnerships, and so on. We have also had the opportunity to work with industry associations in the context of the overall healthcare reform.

What McKinsey brings to the table is a globalized view combined with deep local expertise. McKinsey has always operated under the 'One Firm' concept. We bring the best expertise and the best practices from around the world to serve the needs of our Chinese clients. What has changed is the balance between China-sourced insights versus globally-sourced insights. Today, the

important focus is increasingly to understand the insights we are getting from China and combining those insights with what we know from other markets to deliver practical and insightful solutions to our clients here.

Finally, I am only one of nine partners in our Greater China healthcare practice, and while I primarily focus on pharma and biotech, we collectively cover the full value chain from hospitals, to manufacturers, to service providers or payors. This gives us a unique vantage point on the transformation happening in China healthcare.

In broad strokes, could you highlight the key questions your different profiles of clients are facing in China?

The overwhelming sentiment of the industry is positive. The fundamentals of the healthcare system as well as the sheer size of the market provide enough impetus and driving force for future growth. The China market is still underdeveloped. However, understandably, all companies are facing some pain points.

Multinationals are preoccupied with the question of developing innovative assets in China and improving treatment access, the success of every innovative launch could potentially make or break the business in China. They also continue to worry about the speed at which generic competition for their mature products will intensify in China and whether they have enough time to reposition their organizations and portfolios from their legacy products to innovative products – while continuing to serve the patients that continue to benefit from those legacy products. Given the diversity and complexity of the environment, many companies are also keen to drive digital innovation and form differentiating partnerships.

For the emerging biotechs, typical challenges are often differentiating assets among a crowded playing field, enriching their pipeline, building commercial capabilities at scale, and transforming their organization and talent model to match the long term growth aspirations. There’s often a lot to do and often not enough management attention and capacity for the organization to do it, so a thoughtfully prioritized strategic roadmap is also important.

Local pharmacos are either focused on developing an innovative portfolio or transforming their manufacturing system to improve quality and reduce costs, or both. Another priority is organizational transformation, how to optimize organization structure, streamline management processes, and manage talent.

The themes of globalization and digitalization cut across all these sectors and mean different things to different companies. Globalization for some companies might focus on the clinical aspects of how to design multi-center and multi-country clinical trials and how to develop their products for global markets, or it could mean tangible deal-making and establishing commercial partnerships with companies in other countries. It could also mean designing their organizational set-up internationally or talent management or access to different capital markets.

The same applies to digitalization. Local companies with significant manufacturing operations could be focusing on transforming their facilities in line with Industry 4.0 guidelines. Pharma companies could be looking at new go-to-market models and multichannel strategies. All these require different capabilities and organizational structures. To support these priorities, McKinsey China has established a large local team of product developers, data scientists, experience designers, agile coaches, and other non-traditional consultant roles.

On a more personal note, after 13 years with McKinsey, what keeps you motivated?

I would love to help the local Chinese pharma companies and emerging biotechs reach their full potential. I would also love to help the multinationals because I believe they bring a plethora of capabilities, experience and innovation to China that will fundamentally change the way care is delivered to Chinese patients. Ultimately, all these players can support the better delivery of care and better treatment outcomes in China and eventually, globally. We are in a very exciting period for the development and growth of the Chinese healthcare industry and I am glad to be part of this journey.

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