

Perspective

[The Pharma Drug Probe in China: Shedding Light on an Unfunded Medical System](#)

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Recent Chinese government initiatives, including a focus on preventing corruption, could potentially temper MedTech growth rates in China.

Background

Under the new Chinese Premier, there is an increased focus on reigning in and preventing corruption and commercial bribery across all industries, including Pharmaceutical and MedTech. Various measures for prevention of commercial bribery have already been introduced by the Ministry of Health (renamed the National Commission for Health and Birth Planning). This is a departure from the previous Premier who focused primarily on economic growth.

The Pharma Company And The Probe

According to The Wall Street Journal (WSJ), GlaxoSmithKline's conduct with physicians has been under investigation in China since July. Chinese officials allege that Glaxo employees held fictitious conferences and funneled money for expenses as bribes for physicians and hospital administrators to prescribe more Glaxo drugs, particularly the company's Botox medication.

In other cases, Glaxo employees supposedly organized all-expense-paid trips to desirable tourist destinations in China and Europe. The company confirmed that select senior executives may have

violated Chinese laws and that it was cooperating with the probe. According to the WSJ, Glaxo was alerted to the alleged incidents by an anonymous tipster who said company sponsored trips were part of a broader effort to entice physicians to boost drug prescriptions.

Glaxo sales reps allegedly targeted 48 Chinese physicians and planned to reward them for increasing sales of Botox by offering cash or continuing-education credits. The payments supposedly ranged from about \$245 to \$490.

The WSJ added, “The relationship between Glaxo employees and Chinese physicians shines a light on China’s high growth – but underfunded – medical system”. Industry experts say that physicians are underpaid, which makes them “targets” for honorariums (typically about \$150) and/or speaking fees (typically about \$300) – which are legal – or cuts of sales from drug companies – which are illegal. Some physicians request speaking fees or make side deals in which they secure a 15% to 25% “cut” of the sales of drugs they prescribe.

Cash payments are typically made to physicians by sales reps or distributors in red envelopes – a Chinese custom. Bain and Company assert that the honorariums and “cuts” from the sale of drugs contribute to higher drug costs and overprescribing industry-wide in China.

Why One Company May Have Been Singled Out

Katherine Wang from Ropes & Gray opined that “some of the accusations against Glaxo are not unique to the company and it may have been singled out given Glaxo’s allegedly high amounts of physician payments. The accusations of bribery encouraging physicians to prescribe certain products are not uncommon in the industry – although not likely condoned by corporate headquarters”.

Wang also claimed that while local manufacturers also offer a “prescription fee” to physicians, such payments are usually not documented and thus can’t become evidence against the company. As a comparison, larger multinational companies that pay the same “prescription fees” typically have more precise record keeping that becomes “evidence” for investigators.

Physician Issues Unique To China

Since the Chinese medical system is primarily controlled by the government, physicians are considered – and paid like – civil servants. According to McKinsey and Company, physician paychecks range from \$470 a month to \$1,250 – approximately \$5,640 to \$15,000 annually (or about what an “average” US-based orthopedic surgeon makes in 10 business days).



There is also a deep dissatisfaction among physicians. The Chinese Medical Doctor Association conducted a survey of 6,000 doctors in 2011 – 95% said they were underpaid and 78% confirmed they wouldn't want their children to study medicine.

Physicians in China also carry a heavy workload. According to data from The Ministry of Health, there were 1.49 physicians for every 1,000 people in China in 2011. As a comparison, the World Bank confirmed that the US had 2.4 doctors and Germany 3.7 physicians for every 1,000 people in 2010.

The Competitive Environment in China

The competitive environment for pharma is very competitive – more than 4,000 multinational and local companies sell drugs in China. According to KPMG, drug companies “act more like those of the 1970's in the US, where lavish junkets were part of the culture”.

What the Multinational Pharma Companies Are Saying

Pharmaceutical companies contend that they have strict compliance rules in place, including: internal controls, such as monitoring and auditing – and requirements that all employees have mandatory worldwide compliance training with a focus on corruption laws. Pharma companies contend that action is taken when corrupt behavior is found.

The Potential Repercussions

According to Katherine Wang, “the investigation into bribery against Glaxo will likely spill over to other multinational pharma companies since Glaxo's actions are not uncommon in the industry. As a result, all pharmaceutical manufacturers will likely have to fundamentally change their marketing/sales tactics in China, which may be easier said than done as the local sales reps may not know how to appropriately promote drugs to physicians without incentive programs”.

Wang added, “The investigations will likely drive crosscurrents in SG&A expenses. Companies will likely incur added costs of internal controls; to some extent this could be offset by reduced sales and marketing expenses, as companies exercise caution in the short term”.

The probe will likely impact MedTech as well. Wells Fargo analyst Larry Biegelsen believes that the investigation “could impact medical device companies by curtailing sales/promotion efforts – which would potentially slow the rate of growth somewhat, especially for the premium device segment offered by large multinationals”.



It is also possible that a large multinational company may be singled out by China's National Commission – just as Glaxo.

Summary

Virtually all medical device industry experts expect the Chinese market to continue to remain an important source of growth for the large multinational companies.

However, several recent Chinese government initiatives, including the prevention of commercial bribery and the potential for increasing price control efforts (through tendering) – coupled with “other” health care issues like low physician pay, a surge in patients with chronic diseases, mounting healthcare costs, problems at public hospitals – could potentially dampen MedTech growth rates in China going forward.

Let's hope MedTech executives can continue delivering on their lofty projections in China – the road ahead remains challenging.

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