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Storm Coming? Commercial Compliance Crackdown Shocks China Pharma Industry

Toughest Moves Yet

by Brian Yang

In a new wave of crackdowns on compliance in the pharma sector in China, 10 medical meetings have been cancelled in short order, while sector-wide stock prices have plunged and 100 hospital officials placed under investigation, shocking the industry.

In China's latest crackdown on irregular practices in the pharma sector, not only company-organized meetings but physicians' conferences run by professional medical associations are being cancelled one after another.

While major cities such as Hangzhou and Chengdu cited "security concerns" due to international sports events as among the official reasons, others have simply scrapped all such gatherings.

Amid a tough new wave of official actions, the reactions from the industry have been swift. Firstly, many domestic drug makers announced a halt to academic promotion meetings or scrapped plans for other get-togethers, while some multinationals are re-organizing their medical rep force and commercial business units, with some even started to let employees go.

Hospitals are also not being spared, as more than 100 officials and Communist Party General Secretaries have been placed under official investigation since July.

On 28 July, a joint conference organized by the National Health Commission and nine other state agencies announced a one-year crackdown campaign on corruption in the pharma sector. On the same date, the Central Disciplinary Committee under the Chinese Communist Party (CCP) held a video conference announcing it will work to weed out the types of corruption seen as prevalent in the industry.

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The official announcement on the committee's website calls for sector-wide action, covering the full value chain and promising a systematic overhaul. The focus is on officials and their cadres and staff working in key positions.

Both those offering and receiving bribes will be subject to prosecution and punishment, the announcement warns.

New Focus On Pharma

In effect, the document about the crackdown was issued by May, but got little attention until the influential Central Disciplinary Committee wielded its power and joined the campaign.

Key Takeaways:

- "Cash-for-sales" is the major focus of China's new pharma commercial compliance crackdown.
- Many medical rep visits and academic meetings are being scaled back or cancelled for the time being.
- Many expect the crackdown to last over the remainder of this year and even into next.

Under Chinese President Xi Jinping, who has put corruption and common prosperity at the center of his policies, the Chinese government has initiated rounds of clampdowns on tech giants and online tutor service providers - but so far the pharma sector has received little attention.

> *"The emphasis is on cash-for-sale practices during drug sales, engaged in by drug manufacturers, sellers and medical representatives." - China Central Disciplinary Committee*

This now seems to be changing as the health sector, along with education, are seen as two key areas directly impacting the livelihood of the Chinese people.

The document issued in May gave an outline of the target areas for the crackdown within pharma, one being drug procurement processes.

"The emphasis is on cash-for sales during drug sales, engaged in by drug manufacturers, sellers and medical representatives," notes the document.

VBP Irregularities

China's volume-based procurement (VBP) scheme is laden with irregularities, including that some hospitals refuse to follow through with bid-winning contracts and instead set up obstacles to deter the winning products from entering hospitals. Instead, they procure other higher-priced drugs due to “cash-for-sales” kickback practices (known as “Daijinxiaoshao” in Chinese).

The VBP scheme has attracted much attention due to the high volumes at stake. To slash the prices of off-patent drugs, the Chinese government first implemented VBP in 2018, initially in 11 pilot cities, and then quickly expanded the program to public hospitals nationwide.

The high product volumes and sales values for inclusion of a single drug was seen by authorities as justifying the often very aggressive cutting of prices.

However, VBP has also provided some hospitals with opportunities to evade the scheme and instead to procure from certain manufacturers that offer cash incentives, a practice that is now becoming the epicenter of the crackdown.

Spending Red Flags

One red flag that pharma firms could be subject to the new clampdowns is usually high promotion expenses.

One company cited by the CCP's disciplinary watchdog is publicly traded *Yipinhong Pharmaceutical Co., Ltd.* , which specializes in pediatric and vaccine products. Within its total sales expenses of CNY1.25bn ($174m), "academic and market promotion expenses" accounted for the vast majority at CNY1.19bn. In comparison, R&D spending was CNY190m (including direct expenses of only CNY55m (4.3%)).

The high ratio of 21.5 times sales, marketing promotion versus R&D spending has raised eyebrows among investors, who have questioned whether the firm is mostly focusing on selling or developing new products.

Promotional activities are typically carried out via academic conferences organized by pharma companies and hosted by national or provincial medical and physicians' associations.

Unlike previous rounds, the latest clampdown appears to be targeting physicians and medical associations, pointing to drug makers "using academic activities, hosting or attending medical conference as a pretext to accept donations.”

With many such conferences being cancelled, it signals the new crackdown is thorough and coordinated. Since July, a total of 155 hospital chiefs or CCP General Secretaries have been placed under investigation, the *Daily Economic News* reported.

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Share Prices Affected

Meanwhile, Chinese provincial disciplinary authorities, such as in populous Shandong province, have also hosted video calls to highlight the crackdown activity.

This is already affecting share prices. At market open on 7 August, nearly all publicly-traded pharma stocks on the Shanghai and Shenzhen markets were dropping. As well as Yipinhong, *Livzon Mabpharm Inc*'s parent Livzon Pharma and Changchun HT Bio have so far been hard hit and even major player *Jiangsu Hengrui Medicine Co., Ltd.* was not spared.

One of the worst affected is *Shanghai Serum Bio-technology Co LTD*, a specialty producer of snake bite serum treatments. On 31 July, the company announced its president Fan Zhihe had been detained for further investigation and that Fan's son had taken the reigns of the company. Its stock had nosedived over 13% in two days.

Reps, Records

Some multinationals are also finding themselves in hot water. Some have scaled back rep visits to hospitals, while *Novartis AG* even received an unprecedented request from a major Shanghai hospital.

Changzheng Hospital, or China Navy Medical School Second Affiliated Hospital, sent an official notice to the Swiss giant requesting the reprimand of four reps, citing measures taken as a response to disciplinary inspections. In a response, Novartis China said that the company has received one request from the hospital. Out of two sales reps involved, one has left the company in 2018 and another has not been hired.

Novartis continues to hold high standards and will continue to investigat the matter, noted the company.

Meanwhile, there have been other reports sending shock waves through the already fragile sector. Authorities are said to have taken away storage devices holding years' worth of transaction records. as well as health information system files.

The rumored company, Hengrui, has denied any such activity, but many firms are now worries that the next focus in the clampdown will be sales transaction records.