

When the ₹ drops!

The drop in the Rupee value has eroded almost one cycle of return generated over the last few years by the healthcare ventures for their investors



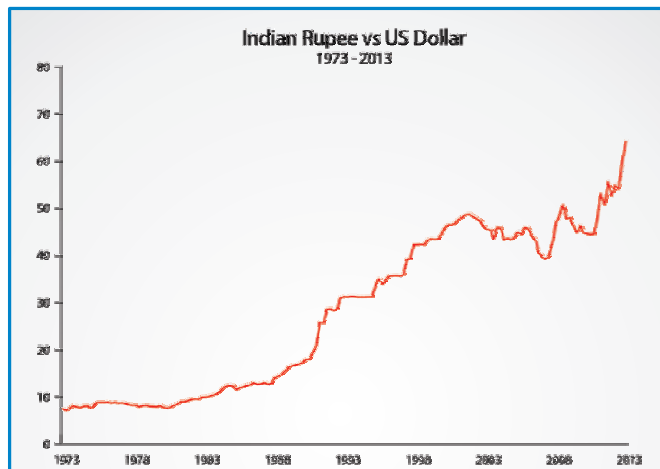
By: Kapil Khandelwal

The last few weeks marked the Rupee with terms 'record low', 'worst-performing currency in Asia', 'retreat', 'pounding', 'crash', 'devalued', 'opportunity' 'losing sleep', 'slump', 'fall'. This drop in the Rupee value has eroded almost one cycle of return generated over the last few years by the healthcare ventures for their investors. Until a few months ago, the Rupee devaluation was one of the least thought of factors

by either the ventures or the venture capitalists and investors that could have such a major impact and change the investor risk-reward dynamics completely. Healthcare industry has not remained stagnant in the face of the numerous challenges it has faced, hence this should also be one of them.

Going into chat shows in media conjecturing on the scenarios and the fear of what next, I postulated what the Rupee impact on the venture capital investments made into different ventures may

borne out to be not just by the Rupee only but also many other factors as outlined in this column. While a lot of the investors like the foreign private equity LPs, who entered into Indian healthcare last few years would be feeling the erosion of their returns on their investments due to the rupee depreciation, the foreign institutional investors have simply exited and swapped into more dollar-reliant IT services players on the bourses. That said, there is opportunity for India in the long term, given its



What determines the Rupee-Dollar Rate

- Growth of the Indian economy
- Inflation
- Strength of the economy including export and import
- Employment/unemployment
- Government
- Public debt and fiscal policy
- RBI intervention
- Interest rates

demographic dividends, large pool of skilled labour and a vibrant entrepreneurial ecosystem that fuels new

ventures to solve health issues for millions of people not just in India but take it to the emerging markets.



Mitigating the risks

The discussion will be incomplete if we do not discuss on the risks of healthcare investing and it is just not the Rupee depreciation that has to bear the brunt. However, it is now more heightened to discuss and address the risks of these factors and mitigate them by the investors and the entrepreneurs alike.

Adoption Risk: The final user of the healthcare products and services is not always the responsible for choosing a particular product or service. Market adoption has a great deal to do with successfully creating demand on the part of intermediaries. Investors must be cognizant of this type of adoption risk.

Obsolescence Risk: Healthtech has a very fast obsolescence cycle and require high rounds of investments to keep abreast of the development in the medical sciences. There are so many products will eventually be surpassed by superior products because the understanding of the disease process increases over time.

Intellectual Property Risk: Large investments are required to develop and roll out innovative treatments. It is likely that product or service will be easily duplicated. Hence, healthcare is expensive and free-riding on intellectual property is a risk that could endanger investment returns.

Clinical Risk: The development of clinical projects has a high failure risk. Given that clinical events are often all-or-nothing propositions, higher discounts are required for clinical

projects, particularly those involving novel diseases or novel therapeutic treatment.

Regulatory Risk: Healthcare regulatory risks are numerous and very often take the venture and investors by surprise.

Although there are enough lobbying that the industry tries to ward off the risks associated with negative regulation these are often discounted when valuing a healthcare venture.

Stepping back

I believe in such uncertain times in which the healthcare industry is going through, we need to step back and go back to the basics. Let us first understand the complexity of the healthcare system in India and the key proponents, which I call the 5Ps: patients, payers, politicians (government), products, and providers.

Investor value is created when we dance the key proponents and driven by

the market power garnered by the product or services that aligns best with the greatest number of proponents. Those products and services that benefit from power shifts exclusively, rather than from providing actual value to multiple proponents, may see a short-term upside, but they will be unlikely to maintain their momentum given the inevitability of future power shifts. In order to determine where the value creation

5Ps – What they look for

<p>Patients:</p> <ul style="list-style-type: none"> Without patient the healthcare industry will not exist Patients act differently as compared to other industry –have no control over the providers or the outcomes Changing demographics of the patients - prevent or reduce the occurrence of secondary illnesses Look out for ventures that are patient-focussed in practice Benefit through insurance, advocacy groups or other intermediaries and self help forums Demanding more information about cost and effectiveness Patients are now more aware of alternative treatments Privacy of their information and non-discrimination 	<p>Payers:</p> <ul style="list-style-type: none"> Diversity in the type of payers that can address the complete spectrum of patient requirements Cost inflation in healthcare will require viability of the insurance models. 3 ways to control the costs <ul style="list-style-type: none"> Restrict the service coverage Reduce provider compensation Increase patient co-payment No single business model has been successful Increased use of information technology and predictive tools for healthcare utilisation Reduced the administrative costs
<p>Politicians:</p> <ul style="list-style-type: none"> Execute policies and entitlements Ensure that medical products are safe and effective Maintain social stability wrt healthcare Dictates on the prices for the other players Activists role of the government in healthcare Universal health for all can substantially expands a market could be a positive for ventures under the right set of circumstances 	<p>Products</p> <ul style="list-style-type: none"> Universal access would increase the product penetration in India Price controls by the Government impacts the scale and growth Intellectual property and patent protection regime in India affects investor valuations Many low cost innovations require subsidies and support to reach scale that are not present in India Many sub-sectors here and difficult to generalise Innovative business models emerging that need long gestation
<p>Providers:</p> <ul style="list-style-type: none"> Change in sentiment has accompanied the changes that providers have seen in their businesses and business models Reimbursement has become more restrictive and regulations have become more complex, leading to increased costs The practice of delivering care has gotten more difficult, provider dissatisfaction has grown Very fragmented and hence not a force in influencing policies positively Investors can generalise that its members want to maximise their income and increase their autonomy Defensive medicine now emerging in some places Regulations that restrict or provide for rampant increase of supply side a concern for all Beyond directly investing in providers, investors should watch the providers because it is the ultimate deciding factor for demand for products and services 	



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will occur, investors have to understand the motivations of different groups.

Other Trends

Some trends in health care will persist regardless of whether or not the Rupee appreciates or depreciates or the way industry tries to manage itself. These though uncontrollable for the industry participants SPs mentioned would have a deeper impact on the industry. These include:

Move towards evidence-based medicine (cook-book medicine): This is an attempt to apply the standards of evidence gained through the scientific method more uniformly to certain aspects of medical practice. Variations from good medical practice, which include medical errors, can lead to negative clinical outcomes.

Consumerism in healthcare: Healthcare consumerism is emerging into

India and is now a global phenomena. Given the greater amount of information and access, people's desire for greater control over their purchasing decisions is a simple concept. As it relates to health care, consumerism says that individuals should have greater control over decisions affecting their health.

(Re)Emerging infectious and chronic disease burden: Many killer diseases are no longer the killers they were due to advancement of medical sciences. When combined with the initial diseases, the comorbidities that emerge over a longer time of treatment an intervention, which otherwise would not have been encountered, lead to complex cases requiring intense medical intervention. As medicine will only get more sophisticated in how it deals with acute diseases, we face a future in which more diseases

that were formerly fatal become chronic and more types of previously unheard-of sets of comorbidities become commonplace.

Move towards personalised healthcare:

There has been much written and spoken by me on this subject in India. Little may suffice to say that the regulation in India is still pre-British Independence Era and efforts need to be made to enabling personalised medicine in India.

Medicalisation of diseases

conditions: Medicine is now capable of altering states of being that people want altered. This desire to expand what is "treatable" is a challenge for healthcare industry and the policy makers in terms of both controlling costs and defining what is acceptable to deal with under the umbrella of healthcare.

Cost control: As the Rupee

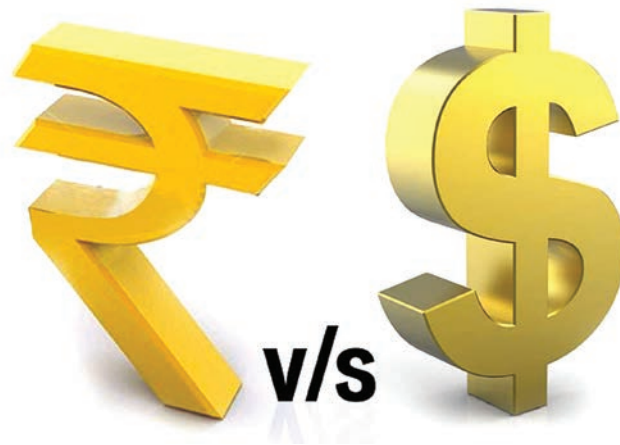
depreciates, there are different strategies the industry players will leverage to get its act and costs under control. A more detailed discussion on this is later in this column.

Globalisation of healthcare delivery:

Over the last decade India has done well in the IT sector in globalisation of the delivery of the services. Healthcare is no exception. Already teleradiology, drug discovery services are being delivered out of India to global customers. As this trend continues, there will be increased competition for resources: scientific, medical, and financial. Recruiting and training providers from other places will alter companies' business models and cost structures as Indian healthcare industry will fall short of talent in the near future.

Information and communication technology (ICT) in healthcare:

A lot has been written and spoken on how ICT in healthcare can bridge the gap of asymmetry of information and other imbalances that are so prevalent in healthcare. Information and the access



to it are competitive weapons for payers, providers, and product makers. Those who are able to gather the most accurate and largest quantity of information can make the most informed business decisions and thus stand the best chances in the marketplace.

Corporatisation of healthcare practices:

Having been part of the journey in India's first corporate group physician practice, the move toward more corporate healthcare does have the ability to improve quality and lower costs, the risks that it might

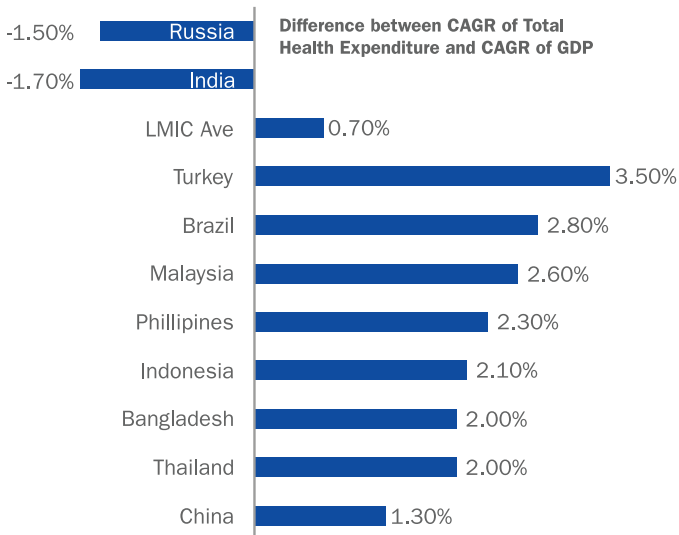
do the opposite are also evident. The corporatisation of healthcare includes the movement of physicians from single- person practices to group practices, increased concentration of membership among larger insurance, and increased concentration among pharmaceutical companies.

There are many ventures that have tried to address each of these trends. A detailed discussion on these nine trends would require a dedicated column for some other time.

Where do we go now?

Some of us are currently sceptical about the broad macro thesis that healthcare is about to change radically and that the mispricing of risk and reward will result in significant opportunity for the investors in healthcare. However, several other factors make healthcare industry worthy of analysis. These include:

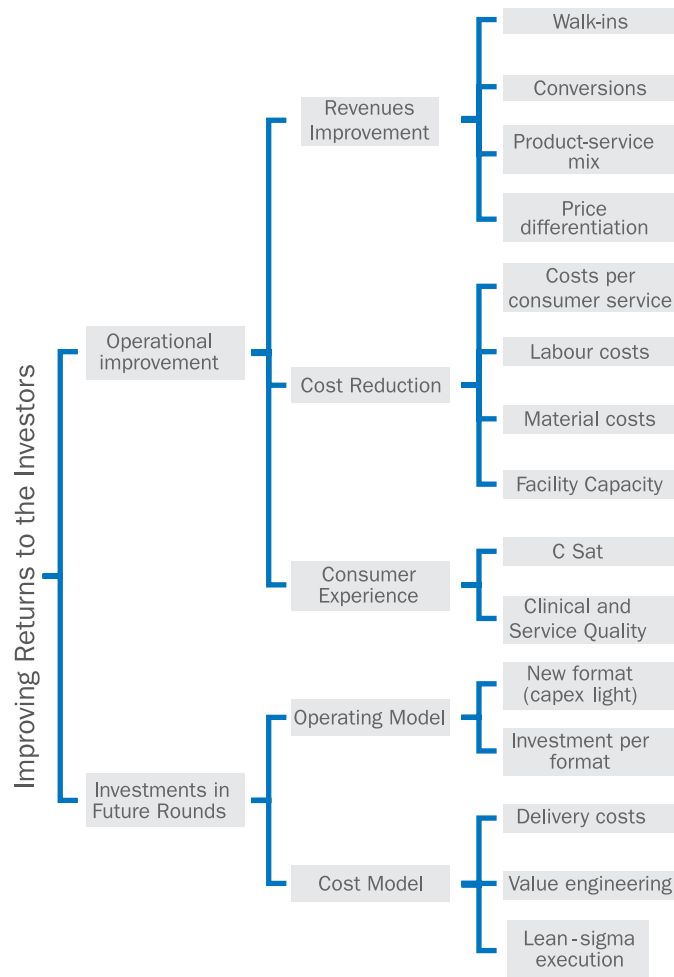
- Demographics, industry size and complexity
- Social interest in healthcare
- Risk diversification
- Inelastic demand for healthcare services
- Market inefficiencies to





About the Author

Kapil Khandelwal has earned recognition as an angel investor, venture capitalist and expert in health sciences, education, agri, clean tech and information communications and technology (ICT). His expertise positions him as one of the thought leaders in India, Asia Pacific and emerging markets. In his 25 years of his career, he has carried out over 30 transactions including cross-border and buyouts. He has chaired various committees at various industry bodies. Kapil runs an early stage investment fund and his own investment banking and advisory services company EquNev Capital Private Limited. He can be contacted at: kapil@kapilkhandelwal.com



exploit and revolutionary potential Most ventures in healthcare would feel the pinch in the short run based on their exposure to the dollar currency and how they are hedged. However ventures that are earning dollars for their services and medical tourism services will be globally more competitive with the countries that India competes with and would fare better in the short term. It is very clear that to neutralise the impact of the rupee depreciation, most of the venture capitalists and ventures are working their strategies overtime to improve

their returns. There are 15 key strategies that they would be focusing to improve the returns. While focusing on the short term strategies in improving revenues and reducing costs would be imperative, the growth imperative and attracting investments in the next round would require pivoting and adapting the business model to ensure that the venture is back on track. In the long term, healthcare is not contrarian investment most of the time. Contrarian investing has been shown to outperform many other strategies. However, the

opportunity for contrarian investing will occasionally also presents itself in healthcare. Changes in the political and regulatory climate happen with some regularity. When these changes occur, they create uncertainty for the healthcare industry and the stocks of companies in that industry. One of the more famous examples is the reaction of the pharmaceutical group to the whirlwind of news flow surrounding the price control package. The shares sold off substantially, but they ultimately recovered and outperformed once the outcome of the policy was known. One of the key issues is that markets are becoming more global. Both human and financial capital is freer to travel than ever before. This trend is going to accelerate as less-developed countries continue to gain economic clout. As the rupee and the other currencies depreciated against the dollar, its impact in the globalisation has increased competition for reasons other than health-care costs, and this has fostered increased economic insecurity among the emerging markets. India is however a huge opportunity as its healthcare spending has lagged behind the growth in its GDP as compared with other growth and emerging economies. **Summing Up** While the Rupee, industry and the general macro-economic environment settles down, it would be prudent to go back to the basics and reassess the risks and the strategies for value investing in the Indian healthcare sector. **HBI**