Interview with Howard Balloch, President, The Balloch Group

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What initially attracted you to China and what kept you here over the years?

I initially became interested in China during university where I studied the country and wrote a masters thesis on China. This was during the Cultural Revolution so it wasn't easy to come to China in those days. However, most of my Foreign Service career was based in Asia, and part of it was focused on China. I was director of North Asia relations for several years in the Eighties, through to 1989. Then I was assistant minister for Asia, looking after our relations with all of Asia and obviously China is a very important part of the region. Afterwards, I came to China as an Ambassador for five and a half years and I liked the story of China so much that I decided rather than remaining in government, I would stay and participate in the China growth story. It has been quite an extraordinary event, encompassing the past 31 years of almost unimpeded growth. In real terms this means the average young Chinese person, never knew the hardships of the Cultural Revolution, the Great Leap Forward or the war against Japan. These young Chinese people wake up thinking today will be better than yesterday, because yesterday was better than the day before. The Pew Center in the US conducts polls on global optimism, and year after year, China is the most optimistic country about its future. Growth rates of about 10% over 31 years resulted in a transformational and fundamental change. China rose from a base that was tragically low; at the end of the Cultural Revolution, the per capita income was lower than it was at the end of the dynastic period in 1911 – that's 67 years with no progress. Thus the determination to find the right

track and stick to it can be found everywhere from the government to industry. It’s an incredibly energetic, entrepreneurial, and ‘go get em’ place.The details of the healthcare reform seem to be released in fits and starts, with information being released very slowly.

As someone who has worked very closely with the Chinese government in the past, why do you think the process has been so drawn out and when do you think we will start to see significant changes in the system?

I think we are starting to see some real changes, but healthcare is neuralgic in almost every country I know. In America a massive liberal brush war is underway over healthcare. In Canada, the growth of two-tier medicine and the end of exclusive universal healthcare is a political issue in every election. In Europe, healthcare is a very significant part of the German and British political debates, as well as probably most other European countries. As we deal with ageing populations and increasing health costs, the role of government in healthcare is almost always courted and the policy debate involves the precise role of government and the degree of responsibility that the government holds as well as the degree of guarantee that the people are due. Thus the debate in China is not very different from the debate in other countries. This country was entirely state run in everything it did until reform began and healthcare was naturally one of the services provided by the state but this began to fragment ten years ago. I remember bringing a senior Canadian official to meet the premier of China a few years ago, and we were talking about the challenges of education and healthcare reform as well as healthcare funding. The premier turned to the Canadian official and said, “We would love to be as Socialist as Canada, but we can’t afford it.” Like many areas of reform, this country doesn’t start from an ideological basis, but rather from a pragmatic viewpoint, recognizing that the provision of basic healthcare services to the people is a necessary component of social stability. There is a growing backlash where experimentation in policies have threatened or even appeared to pose a threat to stability. I remember four or five years ago, where there was a proposal from a foreign healthcare group to start a private hospital. These are gradually being permitted now, however this firm made its bid noisily, promising to take the best doctors from the state sector, which aroused the ire of the Ministry of Health. Of course this was the last thing the ministry wanted to happen, or even to appear to be happening. The foreign company was effectively told to leave, and that they were unable to complete their plans. It’s not only in Liberal Democracies where you have to deal with the political reality of the perception of the healthcare reform. It’s tempting to say that returnees are reshaping China, but Chinese universities are great and produce hundreds of thousands of top-notch scientists.

Thus, what do you think is the real impact of returnees on China generally and on the pharmaceutical industry specifically?

Returnees are contributing a great deal to the growth of the country. It's not just about the science, but also about combining the science and innovation with business. We see that even where local science has produced the advances, the returnee has a large role in the business in terms of access to funds, protecting IP and the operations of the company by developing an innovative business culture. The last 30 years of growth have been accelerated by the fact that Chinese are travelers. There is a tremendous reach of Chinese capital and people in Hong Kong, Singapore, Taiwan and across South East Asia not to mention San Francisco, Vancouver and Toronto as well as the hundreds of thousands of Chinese students who went abroad from the end of reform onwards. This diaspora gives China an advantage that Russia never had, and that India had to a much smaller extent. Even though you have a number of Indian returnees now, no country has external communities like Hong Kong and Singapore. The largest investor in China for years has been Taiwan, even if it's masked through Hong Kong or The Cayman Islands. There are certainly great companies that are run by non-returnees. I work with a company in the neutraceutical space that has been built by a very strong, innovative, intelligent, and capable Chinese chairman who has no experience abroad. The company is listed in the US and has a CFO who lived for years in Canada who provides the understanding of how a publicly listed company works. Thus it wasn't the innovation, the market or the science, but rather the business-side that the returnee helped develop. We are also working with a company in the diagnostic area, and the CEO had spent years working in the industry in New Jersey. What he learned in America was very valuable, but his Chinese staff conceives of the innovations. He surely could have developed his business experience in China, but it would have taken longer.

As locally bred talent moves up the ranks do you think the importance of returnees will diminish over time?

The distinction will become blurred. The National Institute of Health in the United States has hundreds of Chinese employees and this will always be the case. As the movement of people increases, the returnee designation will cease to exist. Nobody in Europe thinks of seeing young Americans or Canadian working in European companies. People move back and forth and we have stopped thinking about peoples' status as to whether you are a returnee or permanent resident. Europe, America and Canada are full of people who came from somewhere else. The issue becomes blurred as the Chinese economy, and this sector opens up and China becomes part of the world.

Could you share some of the milestones of the group in terms of deals, growth and the evolutions in the focus of the business?

I hope we are nimble like many Chinese companies. In this market, companies must change their focus as the market suggests. The milestones were our first deals and every deal is a new milestone. I wouldn't say there have been any watershed events because have gradually built up an increasingly confident firm. As a company, we have two very strong groups in natural resources and life sciences & healthcare. The natural resources group is a function of Chinese appetite for resources and this year we have done more business in this sector than in any other. We have primarily worked in supporting Chinese outbound investment in natural resources, doing deals in oil & gas in Syria and Columbia, iron ore in Canada and copper in Latin America. That almost always involves very large companies, in a market that is dominated by the state sector. We have other groups in education, clean technology, and manufacturing, but our other large group is healthcare and life sciences. This activity is driven by the growth of entrepreneurial China in small and medium sized companies. This is very different from natural resources, encompassing fundraising, private placements, joint venture agreements, licensing arrangements, and some M&A. Emerging as a top player in both of these areas has been very important to the group over the past year. We have punctured through peoples' awareness and are now known as a real player in the sector.

When it comes to your service offering, how would you contrast your services with Bank of America and some of the other big banks with a large healthcare practice and a big presence in China?

The big banks are slow in almost every capacity. We were ranked last year as the number one boutique Investment Bank in China. However, the Balloch Group is not a truly local bank. There is a Chinese expression describing the country's economy, known in English as 'Socialism with Chinese Characteristics.' We are a local investment bank with international characteristics, or rather a small international investment bank with local characteristics. There are a number of very strong local competitors, but almost none of them have the cross-border capabilities that we have, and the big banks really don't have the nimbleness or local knowledge that we have. We can move faster, do more, and have smaller financings. For Bank of America or other great behemoths, every time they move a pen, it costs them a lot of money. Thus they have high costs and tend to be slower. It's very hard for us to compete with them in a multibillion dollar transaction, but we are much better in assisting smaller firms raise USD 20 or 30 million or execute the acquisition of a USD 10 million counterpart with Renminbi funding.

What is your outlook for the industry and for your firm over the next five years?

The industry outlook remains very positive. The drivers are all in place. Healthcare is a function of government being unable to fulfill its basic promises. Moreover, the basic healthcare promises aren't good enough anymore. Healthcare is one of the highest priorities in peoples' spending patterns as health is vitally important here, as everywhere else, and Chinese consumers have more disposable income than ever before. Perhaps the only sector with a higher priority than healthcare is education because that is the future and Chinese people are very happy to make sacrifices today for tomorrow's generation. However, the second priority is most certainly healthcare. Those with the highest income earning capacity are in the central age demographic, ranging from ages 25 to 45. These individuals are concerned with their own healthcare as well as that of their children and their parents. That has an impact on demand for everything from medical services, to pharmaceuticals to medical devices. As China continues to become wealthier, we will see at minimum, a commensurate increase in demand for every segment of the healthcare industry. This industry is also one of the last areas of spending deferment in leaner times. One will defer buying a car, or moving into a new apartment, but one will continue spending on education and healthcare. Thus the sector is relatively resilient to economic cycles and in some sectors, it's fairly price inelastic. Many of the returnees come to China in order to make a contribution and change the image of their country. We came to China thinking we would be doing a report on APIs and generics, but instead, met a number of very innovative companies with top-notch infrastructure and excellent scientists.

How long do you think it will take to change the image of China from a cheap manufacturer to a country that can play a major role in innovative industries?

People in the industry will change their view of China much faster, while the average view of China will change much more slowly. In the 1950's in Canada, the word Japan was associated with lousy quality and cheap work, which is what they were doing in the post war period. Japanese radios or cars were laughed at and it took a generation for the quality to change in fact and in image. It will happen faster with China for a number of reasons, but it will not change overnight. China is special and big, but it is traveling a course that has been traveled before. A lot of the change that is happening here parallels what happened in Taiwan, Korea, and before that in Japan. Relative car ownership during the Olympics in Japan in 1964 was fairly similar to the numbers during the Chinese Olympics in 2008. A number of other criteria are also similar, which implies rapid growth until a point in 30 or 40 years, where China will have a similar per capita income with contemporary Japan. There are catalysts for changes that can come from negative events. The terrible press that China has had for lead in toys, and problems with food products has led this country to work to clean up its act. I think they are making huge ground in product safety and food

quality through inspection systems and the application of standards. However, it will be five or even ten years after every toy that enters the US is safe for Americans to trust in the safety of Chinese toys. This is comparable to the time it took Americans to realize that Japanese cars were higher quality than American cars.

Do you have a final message for the readers of Pharmaceutical Executive?

What we all need to realize is that the Chinese are a lot like everyone else. They demand quality as well as high service and have an interest in improving their own lives in terms of consumption patterns, health, leisure and recreation. The Chinese are going to be consumers of all of our products, both in healthcare as in other sectors, and they will be extraordinarily similar to the rest of the developed world. One of the key differences is China's overhead of 600 or 700 million people who aren't truly participating in the modern economy, but for whom the government must still provide basic healthcare. As these people watch their compatriots in Shanghai live high pace, high fashion, and high wealth lives, they will not be forgiving if their lives get worse. The fundamental component of this quality of life is affordable or state provisioned healthcare.

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