

## “Risk appetite takes a beating”

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*Services, Ernst & Young*

*In a freewheeling interview, Murali Nair, partner, Advisory Services, Ernst & Young, gives his views on the scenario of venture capital funding in biotechnology in the backdrop of the current global economic turmoil.*

#### How has the recent financial turmoil affected the biotech industry in the last six months in terms of venture capital (VC) funding?

Globally, we have to view this recession from two aspects. One is from the traditional business model wherein the funding for biotech companies mostly comes from VCs and private equities (PEs). But, there are not many VC firms that will be able to take the risk of putting in funds for biotech ventures. As far as risks are concerned, my personal opinion of the recession is that, it is more of an emotional decision. It will not take much time for the fundamentals to correct itself but it will take time for the sentiments to come back. Because at the end of the day, growth will not happen just because the fundamentals have corrected itself or somebody is giving credit loans. Risk appetite is the key for any development. That takes a very big beating when you have a recession.

In India, the extent of the recession is far more than the actual market reality and I do not think we are affected except a few sectors. When you decide on investments you spread it across categories like low, medium and high risk, where the high risk gets eliminated. Biotechnology was never a low or medium risk investment that is the challenge when biotech funding goes globally. If you look at the funding globally, it is mainly done by the government or VCs (almost 60 percent). Now, even the government is under tremendous strain as it is now looking at bringing in generic drugs and possible ways to cut health care costs.

Funding, which is the oxygen for biotechnology, being an innovation-driven industry, will be a challenge if you look at standalone biotech companies. However, it is difficult in the case of pure biotechs diluting their place to pharma companies.

Big pharma has no option but to look at biotech if it wants to fill up its pipeline. The entire innovation game will now be played very differently. The big pharma companies are sitting on tonnes of cash and do not have debt. The big biotech companies will get acquired while the small and medium companies will see a lot of alliance relationships.

VC-based funding can take you up to a certain level but in order to get the benefit, commercialization of products which the biotech companies in the past have found it difficult to handle is important. It will be a synergy of capabilities.

### Is innovation one of the reasons for VCs in India to take a backseat?

Innovation as a culture never existed in India in a manner that would have facilitated basic research. Our focus for basic research or rather innovative research was very limited for many years. Even the big pharma companies started investing in basic research only a few years back and biotech being a much smaller sibling than pharma naturally did not have place, ambition and aspiration to build basic research.

Globally, the difference between biotech and modern pharma is that biotech is far more fundamental because it goes back to the genesis and synthetic pharma is less more complex and understood by a larger majority of people.

India's biological capabilities are lesser than the chemistry capabilities and China is far ahead of India on biological capabilities. The very nature of investment is also tough because biotech addresses the very fundamentals of a subject and it is a new topic. But any thing that is radical will take its time to establish itself even intellectually.

Globally, if you take the top 50 companies they spend nearly 30-40 percent of their turnover on R&D and out of this 40 percent comes from VCs. India spends only close to six percent despite a small space. In the Indian market, the concept of VCs is very new and we do not have many VCs. Yet India has done a great job. We have been able to create an industry which is starting to innovate and identified business models. The Indian biotech story has not been a failure in anyway.

### Should there be an industry-academia linkage in biotechnology to promote innovation? Should there be some sort of funding on these lines?

The academia-industry linkage has been the engine for innovation. In Indian context, to deal with the Indian academia is very tough; there is tremendous resistance and the sense of commercial understanding is lacking. The US faced a similar challenge in the 1950s and 1960s that is when they came out with an act which actually improved the industry-academia linkage and the ability to do commercial research, earlier it was only restricted to journals. India is also planning to propose an act named Public Funded R&D bill, which is inspired by the US act. The act will allow the researcher and the academic institutions to hold the IP right, that is a good incentive because today a researcher thinks he has no stake in the process as the government holds the IP. This act will be a good catalyst and will lead to an effective commercial relationship between the industry and academia. People will be engaged in a meaningful commercial research while they are still on campus and it will facilitate a number of research projects because the infrastructure gap can be narrowed and can be balanced.

Biotechnology as a sector is an answer to so many unanswered issues. We traditionally have not been able to participate in innovative activities because of lack of funds. I think it is a national issue and not a company issue. This is a sector where small guys cannot afford and the government funding can be at a project level. The Government of India has also declared that it will allocate \$2 billion for R&D but that alone cannot help. If the fund is given individually to companies that will not be a good model. The main intention should be to create a common infrastructure to leverage the strength. So the best way to utilize this fund is to invest in Bt parks, strengthen academic institutions with best infrastructure so that within one umbrella a company and institutions can all work together. So here we have limited investments being exploited by multiple number of players for innovation. We need to create central infrastructures or shared capabilities and infrastructure.

### We saw a lot of companies hiving out their R&D units. Was it a feasible model considering that a number of PEs and VCs backed out mid way from such ventures?

Considering this model, companies wanted to de-risk their generic business because all of them are listed. The discovery research was sucking up a lot of money which was impacting the performance of the entire company and in any drug discovery process its a long gestation period. Indian markets and investors do not understand that in a very significant way. So the segregation happened to de-risk their generic business and to bring a clear focus, but unfortunately we are seeing many deals closing. In concept, it was good to have a risk capital and funding for the discovery part, but the expected success did not happen. Because at the end of the day discovery is long drawn process and you need to have a different set of investors with a different mindset who can understand innovation investments. Market and investors will take time to understand this model.

### From the VC firm's point of view, how attractive will be the biosimilars market in the near future?

Biosimilar market has superior opportunities than pharma generics. Globally we can expect a certain price correction. However generics are here to stay and grow in time. In the US the generics prescription is 60 percent and with the arrival of Obama it will grow over time. Biosimilar is a subset of generics. Traditionally the market for which big pharma has made branded products catering to the 1.5 billion population now this 1.5 billion population is under the strain of genericisation. To have sustainability, big pharma or big biotech will have no other option but to typically cover the remaining population which is a semi regulated part of the world and this part will never be able to afford the prices, this is also applicable to biosimilars. Biosimilars will be a more strong a proposition than generics because they are difficult and complex to emulate. Today the

entire pharma generic space will see a tremendous price erosion up to 90 percent. That may not happen in biosimilars, the price erosion may go up to 50-60 percent.

**What according to you will be the five trends that will dominate the Indian biotechnology industry?**

We will go the innovation way, if companies aspire to be in a dignified position, imitation will always put you in a secondary position. Hence investment in innovation is the right thing, since there are a number of corporate companies in India actively committed to innovation. We will also see government funding in terms of providing finance, getting into PPPs, direct funding, their role in development of this sector will be primarily as a financier and peer regulator.

There will be globalization in biotech. Biotechnology is largely India-centric; in the future, we will be a part of the global market and will be a part of the pie across the value chain. There will be a lot of marketing alliances where companies abroad can come and Indian companies will play the role of CSOs (contract sales organizations). They will look at alliances across the value chain. The public R&D bill will change the dynamics as the industry-academia linkage has an important role to play. Regulations will play an important role for successful implementation of the first three trends. Lastly on the globalization front, other than business opportunities and capability development, globalization will expose us to actively learn the expertise from the partner, South Korea is a best example for this. The alliances prepares companies to go to the next level.

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