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CFO Perspectives
CFO Speaks

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1. **GST will soon be a reality. How well you think industry is prepared and as a CFO what are the benefits you anticipate for the pharmaceutical industry?**

   Currently service sector contributes 55-60% of India's GDP, whereas manufacturing sector contributes 18-20%. However, tax collected is only 2% of GDP for the services sector, whereas manufacturing sector accounts for 7-8%. This is a dichotomy and GST will certainly bring in significant tax reforms with uniformity, compliance structure and increased penetration. I feel that major impacts GST would bring in are:

   i. Companies will have to re-formularize their pricing strategies.
   ii. Compliance would be a huge challenge.
   iii. Supply chain and Standard Operating Processes (SOP) will have to be re-looked.

   In the pharmaceutical industry, currently we pay around 11% tax and hence any increase in GST rate to much talked about rate of 18% would lead to price adjustment. Any adverse policy would impact the industry. As healthcare is a basic need for any society it may not be good for all. We are gearing up for the compliance and have also taken relevant steps to integrate our IT systems.

   In my view, change of technology, affordability and implementation would be an issue for smaller enterprises versus the bigger companies. GST is an ambitious project and would be challenging for the government, industry and advisors. These challenges would be different for businesses operating in different states. And one should keep in mind that there is no precedence of GST implementation anywhere in globe with federal structure of 29 states, 7 union territories and over 1.2 billion people. I would presume that legislators and policy makers are fully cognizant to that.

2. **Indian healthcare is one of the fastest growing sectors. What are the opportunities and challenges you foresee for the industry?**

   As per one of the Deloitte reports that I read, "The healthcare industry is expected to grow at 26% CAGR and by 2020 the industry's size will be USD 280 billion from USD 80-100 billion currently", and there is no doubt of the fact that Healthcare industry is poised for growth.

However, healthcare infrastructure needs focus. With a population of over 1.2 billion, our country needs 700,000 beds in next 5-6 years to get close to World Health Organization (WHO) standards of one bed per 250 people. And this means a humongous investment of about USD 30-35 billion.

Thus, we need attention of private equity and venture capital (PE/ VC) players in the sector. Further, for the model to be sustainable beyond tier-I and II cities, it goes without saying that government support would be critical. It's imperative that we get more capital investment with loans for longer duration, faster regulatory clearances and evolved structure of insurance to cover all major and critical illness.

Some of the sectors in India get technology upgradation subvention from government but somehow healthcare remained out of this mechanism. I think extending such support would help in modernizing healthcare facilities where technology is the key.

With rising income, inclusive fiscal policies and more digital adoption, my feel is, this industry would grow and would be critical contributor to the economy. Compared to per capital healthcare expenses of some of the developed / developing nations our expenses remains meagre at less than 70 USD. The industry also faces very high sales outstanding (DSO) and faster and transparent settlement processes to free-up the working capital would be critical for the industry.

Country like us needs concerted effort in healthcare to ensure sustainable and inclusive growth and that can come with reducing infant mortality rate, maternal mortality rate, reducing malnutrition among children, etc. which would remain a distant dream without commensurate investment in the sector.

3. **Medical tourism in India has been growing. Do you think we are positioned well in terms of talent availability, policy and infrastructure support?**

The perception about India's medical tourism across the globe is low cost advantage / arbitrage. But we also need to make people aware that it's not only the cost, but the quality of healthcare services India offers is also comparable to the best with advanced procedural expertise, comparable practices and facilities. The Medical Tourism Market Report 2015 described India as "one of the lowest cost and highest quality of all medical tourism destinations" as it offers wide variety of procedures at about one-tenth the cost of similar procedures in the United States and also have the second largest number of accredited facilities (after Thailand).

According to one of the studies, medical tourism market is expected to more than double in size from current USD 3 billion to around USD 8 billion by 2020. Hopefully with shorter approval processes, easing of visa on arrival, english speaking medico/ para medico professionals India stands to gain in medical tourism in future.

4. **What would be the impact of 'Brexit' for pharma companies having an exposure to European markets and what are the likely challenges you as a CFO would face?**

Our UK/ EU operation is about 30% of global turnover wherein we have R&D, manufacturing and distribution, exposing us to GBP, Euro and USD; in combination of both working capital and invested fixed assets. Thus, losses and gains on translations will continue to happen. However, one has to redefine pricing strategies to de-risk devaluation of GBP or to partially recover the losses.

Currently, UK is part of European Free Trade Association (EFTA) and European Economic Area (EEA). If they choose to remain part of Single European Market Regulations along with EEA/ EFTA, the impact is expected to be less even after implementation of Brexit. Otherwise, there could be changes in free flow of capital, goods, services and labour. We still need to see how this shapes up in future and whether UK continues to be part of EFTA and

EEA. Similarly if existing Double Taxation Agreements under EEA/ EFTA undergoes any major moderation, parent subsidiary directives under existing treaties takes different shapes over the period then the world could see major impacts and could also shift London's stance, which is currently positioned as financial capital in EU.

5. **The 'New drug pricing control order (NDPCO)' issued by Directorate of Food and Drugs in 2013 was a milestone in itself. With such policy interventions, how do you manage the challenge of pressure on margins?**

   Moving out of cost based approach to market price driven approach is worldwide accepted as prudent and better mechanism, but it comes with inherent complexities. While arriving at the pricing of drugs, adjustment of various Stock Keeping Units (SKUs) based on its potency, size, etc. should have been factored as manufacturing and distribution of different SKUs have different costs associated with it.

   One needs to understand that price control mechanism works well in certain fields, certain economic segment of society but it should come with pragmatic approach of protecting the producers and sellers also whose capital gets impacted due to such policies. I am not talking about return on capital but the basic principle of capital protection and continuous investment in plant and machineries, technological obsolescence and on R&D. If industry is continuously being put into the edge of uncertainty of long-term price stability the only thing that would get impacted is supply or availability of essential medicines. No one in this world can continuously manufacture and distribute/ sell at a loss.

   I think long-term success of any industry depends on discovering, developing and innovating cost-effective medicines and responsible encouragement by the government for industry to continuously invest rather than only control the end product pricing. Hence a policy that sets a trend of certainty in manufacturers mind with a pragmatic price support mechanism to the producers who sells below cost of production for the benefit of masses would be welcome.

   Further, "generic drugs do not require R&D" is a misconception. Some of the critical medicines need continuous development and could not be afforded to be off-shelf to protect consumer's interest and patient safety that are paramount to pharma industry. And accordingly, one needs to wisely choose between "availability versus affordability".

   Pharma is an industry of hope, industry for mankind and industry truly dependent on R&D which can fuel unprecedented growth over any other conventional industry. Thus system needs to support the industry for long term sustainability of supply of critical drugs in the market and socialist principle of patient safety and affordability should not be taken over by the populist approach.

6. **As you expand your footprint globally, how do you cope with increasing regulatory challenges?**

   I agree with your point that navigating disparate regulatory requirements can be confusing, time consuming, and risky. A lack of understanding about a particular regulatory agency's requirements for processes or facilities can lead to excessive delays in market authorization, thereby affecting a product's opportunity for success in a highly competitive market.

   So a truly global approach to regulatory issues, building a strong working knowledge of the countries and their regulators, and adequately preparing for the rigorous process of submitting applications and undergoing regulatory review would be key challenges. Having said this, regulatory challenges are also beyond operative environment / regulations/ approvals at various markets. Industry is facing constant challenges in other economic regulations/ framework whether it is IndAS, GAAR, BEPS, transfer pricing, etc. I think world has changed maximum in last couple of years and economic compulsions of developed and developing nations will rechristened its level playing fields in near future.

All these need to be tackled continuously and will remain one of the critical focus areas for CFOs in the days to come.

7. **What are the 3 key challenges you face as a CFO of an organization which is continuously expanding its global footprint?**

   I think in last couple of years most defined and deliberated role in corporate world happened to be of CFOs. And that's due to demanding and self-conflicting issues thrown upon to the CFO community in every economy.

   Whereas organizations aspiration for growth could not be ignored, how the growth is being achieved to make it sustainable, responsible and non-regressive for most of the stakeholders would be a balance that is difficult to institutionalize. And I think all regulators worldwide put it more to the CFOs as structurally they are perceived to have an overall view of the processes of an organization which of course is a debatable subject. So apart from industry related challenges CFOs are to play a key balancer of:

   i. Bringing in right value add to the organization in terms of assessing risk and reward and making it amply clear to all stakeholders from inception to end.
   ii. Bringing in right mix of Capital at right cost to ensure capital related charges don't eat up EBIDTA and also ensuring adequate liquidity in the business processes.
   iii. Institutionalizing governance practices that are best in class to make sure sustainability of the organization is ensured. Most of the professionals confuse themselves with regulation versus governance, **where regulation is meant to follow, governance is meant to create an environment to follow**.

Expert Views

The evolving role of the CFO in today's digital environment

Digitization[1] has brought about a paradigm shift in how business is conducted. While digitization had led to greater global collaboration, improved efficiencies and access to new markets, it has also spawned new fraud risks, including those arising from use of social media, ecommerce, cloud computing and crypto currency (such as Bitcoin). As the adoption of these technologies in business continues to grow, the impact of corresponding frauds can be crippling.

The Deloitte India Fraud Survey 2014 highlighted the following key fraud vulnerabilities organizations faced when using new technologies:

Technology adopted	Potential fraud vulnerabilities
e-Commerce	Online payments, procurement of materials, and trading in stock markets.
Cloud computing	Data loss from unauthorized use of low-quality systems, hacking, theft of intellectual property, and theft of confidential customer data.
Social media	Data disclosures including sharing of confidential information such as client names, financial details, reputation related matters, or forward looking information such as business plans; hidden URLs that download malware; IP counterfeiting, counterfeiting or piracy; scams or phishing fraud.
Crypto currencies	Speculative trading leading to volatile exchange rates, theft of currency.

The survey also highlighted that traditional fraud risk management practices were perhaps inadequate to address these emerging fraud risks. A dedicated fraud risk management plan based on adequate understanding of these fraud risks was deemed essential. This is where we see the Chief Financial Officer's (CFO) role transforming from that of a steward to a strategist.

The CFO today holds a unique position within the organization:

With electronic data at the center of organizations, the CFO, by virtue of being the custodian of data, is in a unique position to leverage it for multiple purposes that include business forecasting, operational effectiveness, fraud risk management and change management. Specifically in the area of fraud risk management, the CFO's role is enhanced because of significant dependence on data analytics tools to assess critical patterns and understand potential scenarios of fraud. CFOs, therefore, need to better anticipate and plan for the business impact of emerging frauds that are propagated using digital technology. To do this, we suggest focusing on three key aspects:

a) Working closely with third party experts to understand emerging fraud risks

Third party experts such as forensic accountants and lawyers may be able to provide insights into emerging fraud risks and its impact on organizations. Unless CFOs are able to estimate the potential impact of fraud arising from certain business decisions, they may not be able to advise their organizations and prepare to tackle it.

b) Working with industry bodies and regulatory agencies to develop preventive frameworks

The Companies Act 2013, is a good example of how organizations led the government to pass a path-breaking legislation where fraud was defined and mitigating measures were indicated for the first time in modern India. Going forward we believe successful compliance with legislation can be a game changer for companies and provide them with a strategic advantage. CFOs are best equipped to drive this within organizations.

c) Investing in skilled resources to manage fraud risks effectively

The CFO's ability to manage fraud risks effectively will contribute to his might as an astute strategist. While every organization thinks of growth, the ability to manage growth by predicting and tackling stumbling blocks will differentiate a successful CFO from a less successful one.

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[1]Digitization refers to the reliance on digital technology such as computers and the Internet for accomplishing defined tasks.

About Deloitte's CFO Program

The CFO Program brings together a multidisciplinary team of Deloitte leaders and subject matter specialists to help CFOs stay ahead in the face of growing challenges and demands. The Program harnesses our organization's broad capabilities to deliver forward thinking and fresh insights for every stage of a CFO's career – helping CFOs manage the complexities of their roles, tackle their company's most compelling challenges, and adapt to strategic shifts in the market.

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