Eilert Hinrichs, partner, and **Michael Wisniewski**, manager at L.E.K. Consulting, explain that investors must understand the local dynamic if they want to create value in healthcare businesses in Central and Eastern Europe

A fragmented market

When patients visit the Váci Greens Health Centre, they have access to what the operators claim is state-of-the art diagnostic imaging, preventive screening and outpatient care, across 16 specialist areas. The centre, located in a business district of Budapest, targets corporate healthcare and private patients.

Váci Greens, which started in 2017 as a joint venture between Hungarian groups Fonix-Med and Affidea, not only offers cutting-edge medical facilities, it also symbolises a broader trend in the Central and Eastern European (CEE) healthcare sector: consolidation.

Affidea acquired Fonix-Med last year, cementing its place at the forefront of the Hungarian private health sector and marking a significant milestone in Affidea's European expansion.

Similar deals have taken place across the region, such as Poland's PZU Zdrowie, which earlier this year bought Alergo-Med, a specialist clinic in the south-east of the country, and Regina Maria buying Ponderas.

CEE healthcare is undergoing a wave of mergers and acquisitions amid increasing spending and a drive to improve services. With a total population of 120 million, the 16 countries in the region present enormous opportunities for both healthcare providers and investors.

Yet the market remains very fragmented and is challenging for even the most knowledgeable and experienced operators, and providers and investors must develop a deep understanding of each market's local dynamics.

The nature of the market

The root of the consolidation in CEE is the fragmented nature of the market, a legacy of the former communist system.

When CEE states such as Poland, Hungary and Romania split from the Soviet bloc in the late 1980s and early 1990s, healthcare services were hospital-based and inefficient.

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Private healthcare providers identified an opportunity to develop community and clinic-based offerings.

The early medical entrepreneurs were local doctors who discovered that patients were prepared to pay for services in medical areas underprovided by the public sector. Others were larger groups that began to offer a range of services, primarily those underprovided by the public systems.

As private care expanded across the region, governments began to reimburse the private sector, providing access to more funds. Approaches began to diverge – Slovakia, for example, adopted private insurance – and countries that joined the European Union gained better access to finance.

The shortcomings of state-run healthcare systems in CEE were laid bare. As patients demanded improvements, another wave of providers emerged, with business models that played on inefficiencies of state services.

Up until that point, private providers had been centred in local communities and fragmented. Care was paid for by a mix of public, out-of-pocket and nascent insurance funds, and providers had been set up with local or borrowed funds rather than parachuted in by foreign investors.

Foreign healthcare groups began to pay attention, seeing opportunities in the growing demand for resources that required access to more capital and know-how than existed in CEE countries.

Váci Greens Health Centre, Budapest, Hungary

In dialysis, for example, western groups took over rundown public units at hospitals and acquired inefficient and cash-strapped local independent groups to form networks.

Similar trends occurred in diagnostic imaging, albeit more slowly because it was not seen as an acute need.

Diagnostic imaging also exposed another motivation for consolidation: access to shared resources. A shortage of radiologists in the face of strong market growth meant that tele-radiology had to develop rapidly, benefiting networked care providers that were able to set up central functions.

Similarly, medical laboratories pooled resources to create the capital and process know-how to operate efficient central labs, giving back efficiency to the public sector.

Consolidation endured and another round was prompted by a new type of healthcare customer: the corporation.

With state-run healthcare still ineffective and often poor quality, multi-nationals, banks, insurers, telecom groups and other white-collar enterprises became increasingly keen to offer simple and efficient primary healthcare services as a perk to their employees. Subscription-funded outpatient services and clinics sprung up to meet demand, merging to serve their customers on a nationwide basis.

In Poland, for example, Mid Europa Partners fused several providers to create LUX MED, which would go on to make further targeted acquisitions under Bupa's ownership.

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In Romania, Regina Maria emerged as a consolidator across multiple medical disciplines.

As private healthcare services proliferated, some medical specialties approached saturation. In response, regulators and national payors started limiting the growth of publicly funded provision, ushering in a new motivation for consolidation: territory.

Knowing that competitors would struggle to compete against incumbents, providers acquired to grab space. Specialities included diagnostic imaging, dialysis, interventional cardiology, stationary rehabilitation and radiotherapy. Businesses did not have to be profitable, they just had to be first.

Significant opportunities ahead

A more recent phase of consolidation has stemmed from less tangible, but nevertheless very important, factors such as quality of care, protocols and brands.

Healthcare networks have started to implement care protocols, establishing medical boards and creating international affiliations with reputable centres of excellence. Some have grown large enough to be seen as centres of excellence in their own right, such as Affidea. They have also started to pay closer attention to patient satisfaction. Hub-and-spoke concepts have started to emerge, such as by American Heart of Poland, Regina Maria and Diagnostyka.

Again, the thinking comes from the West, where these trends are well-established, and they have been stimulated in the CEE by foreign investors making acquisitions or consolidating existing market segments.

As a result, local specialist providers top the target-screen shortlists for foreign healthcare providers and investors looking to make forays into CEE.

Significant legwork, however, is required, and such businesses need to be built from an existing three to five sites into platform status.

At a larger scale, region-wide investment would mean acquiring national quality leaders across CEE to provide segment and quality focus, maximising exposure to opportunities while diversifying risks.

Cross-border consolidation also offers opportunities for investors, especially given the high number of small countries in CEE, yet there are substantial difficulties in executing successfully. The small size of individual systems has hampered locally sourced growth, and the variety of healthcare systems, languages and local know-how across CEE has kept potential consolidators largely within country borders. However, with the right strategy and focus, cross-border consolidation is possible.

The concept is proven by providers from smaller CEE countries which have ventured abroad sooner, having met limitations to their growth ambitions in their own markets.

Examples include Czechia's Lexum, which expanded its eye clinics into Poland and was acquired by the UK's Moonray Healthcare; and Amethyst, a Romanian radiotherapy specialist that expanded into Poland and France.

Not all areas of CEE healthcare have been part of the consolidation trend.

Traditional hospitals and ambulatory polyclinics have been less affected because they do not offer specialist, technology-enabled services. Yet, even here, PZU and pharmaceuticals wholesaler Neuca have built chains of more than 60 outpatient centres in Poland, as well as many smaller polyclinic networks across the region.

There are networks of five to 15 hospitals in Poland, Czechia and Slovakia that have been established largely out of public units looking for better management and funding.

Penta Hospitals manages a network that is international and working across in- and out-patient settings.

Potential opportunities for the next wave of consolidation may come from areas in CEE healthcare that remain highly fragmented and would significantly benefit from enhanced standards. These include dentistry, IVF, day-rehabilitation, aesthetic medicine, eye clinics and ENT clinics. They are bolstered by their reputation as specialists in their field and are likely to benefit from efficiencies of scale, offering investors a range of small networks with professional management and strong medical ambitions.

The CEE healthcare market is not for the faint-hearted. Providers and investors must understand the local dynamic, and how they can create value in healthcare businesses.

There are significant rewards for those who can navigate local system complexity and show consumers that they understand what good healthcare looks like.

Ponderas Hospital, Bucharest, Romania