INVESTING IN HEALTH

As public hospitals continue to prevail as the dominant healthcare providers in China an increasing burden is placed on the government in terms of funding and administration. Facilities exceeding capacity have led to increasing numbers of complaints from patients who are not getting adequate access to healthcare services. Reforms to the public healthcare system are urgently required.

Eric Yan and **Helen Chen** from **L.E.K. Consulting** say that the Chinese Government has already started to take some measures by further opening up the healthcare sector to allow increased foreign investment to flow in. Below they discuss some of the options that are available to potential investors.

In March 2013, the Shanghai Government issued *The Implementation Suggestions on Further Development of the City's Social Medical Institutions* (Article 28), which expressed unprecedented support to privately-funded medical institutions. Article 28 not only includes and prioritises private medical institutions in regional healthcare system planning, it also provides substantial support in finance, land, tax, registration processes for physicians, and medical insurance, providing significant incentives for those looking to get involved in the private healthcare sector.

"As the only municipality among the 16 selected cities piloting the public hospital reform, Shanghai's policy move is particularly noteworthy since it may set the direction of the national reform for economically developed cities in the future", says Ms Li, a member of United Family Healthcare's senior management team who has over 10 years' experience in managing foreign/joint venture (JV) hospitals in China.

Their vision is to keep public hospitals as the providers of basic healthcare needs and supplement this with a privately-invested healthcare system that offers advanced and specialised healthcare services. Private healthcare providers are already receiving considerable policy support from the government to facilitate their development.

Does this mean the time is right for investing in this sector? How should investors or hospital management evaluate the potential opportunities and risks?

Investors can consider two basic models for market entry and later expansion (see Table 1): set up a hospital from scratch and then expand it into chains, or acquire existing hospitals. Each model has its own pros and cons and both have been analysed and accepted by different investors.

In addition there is a third model — hospital trusteeship — whereby organisations manage but don't own the hospital. This model is recognised by some large hospital management groups, such as United Family Healthcare, as an additional pathway to expand.

Based on our analysis of many hospital expansion cases, we have found that Parkway Health and Phoenix Health, two representatives of foreign and domestic healthcare management groups, both have very flexible expansion strategies and actually employ all three of these models concurrently to quickly expand their businesses in China.

Hospital models for establishment and expansion (Table1)

	Build from scratch	Acquisition	Trusteeship
Advantage	● Universal brand and standardised operation models are easy to manage and replicate.	● Fast entry and expansion through acquiring existing assets	● Asset-light strategy with lower resource requirements such as labour and capital.
Disadvantage	● The process of establishing the very first hospital, standardising operation models and expanding through self-replication could take a very long time and require significant resources, such as labour and capital.	● Difficult to evaluate target hospital and to integrate its business post transaction. ● More difficult to form a universal brand and manage affiliates at a high standard. ● Higher capital requirement.	● Managing hospitals based on contracts without owning them may bring potential uncertainties. ● The managing party only receives a portion of hospital income as service revenue from the hospital owner.
Examples	● United Family Healthcare ● Parkway Health ● Amcare ● CHC Healthcare ● Phoenix Medical	● Parkway Health ● Phoenix Medical ● Asia Pacific Medical Group (APMG) ● Fosun and other comprehensive healthcare groups ● Sinophi Healthcare	● United Family Healthcare ● Parkway Health ● Phoenix Medical

Source: Company websites, L.E.K. interviews and analysis

Selecting the right business model and deciding which therapeutic area (TA) to focus on is another key concern for potential investors. Should they choose to invest in clinics, hospitals or rehabilitation centres? Should they focus on general healthcare or specialise? Different types of hospitals could vary significantly in terms of entry barriers, investment requirements, management challenges and financial return.

When making decisions, new entrants should carefully consider these factors and choose the most appropriate business model and TA focus (Table 2).

Hospital business model and therapeutic area (Table 2)

Business model / Therapeutic area	Clinic	Hospital	Rehabilitation centre
General	Supplementary to hospitals. • United Family Healthcare • Parkway Health	• United Family Healthcare • Parkway Health • Shanghai International Medical Centre (Under Construction)	In the early stages of development. Most are still under construction.
Speciality – high entry barrier (oncology, cardiovascular etc)	Limited demand.	• Concord Medical Services* • Wuhan Asia Heart Hospital • Tianjin Jiexi Oncology Hospital (under construction) • Delta Health ** (under construction)	
Speciality – low entry barrier (ophthalmology, dentistry etc)	• Arrail Dental Clinic	• Aier Eye Hospital	Limited demand.

Note: * Oncology; ** Cardiovascular Source: L.E.K. analysis

In addition, investors should also think thoroughly about how to position the hospital and which patient group to target — the high-end *niche* segment or the mid- to low-end mass segment. Foreign or JV hospitals are usually different to domestic private hospitals in market positioning and model of operation, which can produce very different results in financial return (Table 3).

In interviews with domestic, private hospital management, we found that some organisations are displaying an increasing desire to gain some share in the high-end segment. An example of this is the Hai'an Haibei Hospital, a domestic private hospital in Hai'an city, Jiangsu province.

"We hope to establish a partnership with someone that can bring external experts so that we could offer premium medical treatment with high-quality services to high-net-worth patients. They have lots of money, so as long as the physicians and services are good they should be willing to come to our hospital," says Mr Jiang, the owner of Hai'an Haibei Hospital.

Hospital target patient and operation models (Table 3)

	Foreign (or Sino-foreign JV)	Domestic private hospital
Target patient	• Expats and affluent people • Middle class (new target patient group)	• Generally low-income people
Operation model	• High-quality medical services • Not covered by public medical insurance programmes • Collaboration with private medical insurance programmes	• Ordinary medical services • Some hospitals are covered by public medical insurance recently
Example	• United Family Healthcare • Parkway Health • Amcare	• Many domestic private hospitals

Source: L.E.K. analysis

Under China's current policy and regulations, the profit model of a hospital is another key factor that hospital investors need to consider— for-profit or non-profit? The biggest difference between these two models is the way in which they are able collect financial returns.

In principle, investors in non-profit hospitals are not allowed to receive any financial return directly from hospital operations. However, extracting profit from special 'grey area' arrangements is already a well-known latent rule in the industry. These two models also differ widely in operating cost and tax policy.

The advantages of the for-profit model are that financial returns can be received directly and they are flexible in operation; the disadvantages are the high operating costs and that income tax needs to be paid. The advantages of the non-for-profit model are lower operating costs and taxes, and it is easier for them to be included in the public medical insurance scheme; the disadvantage is that there are potential risks in the way that financial returns can be gained.

Our analysis shows that different investors also have dissimilar views when considering this factor. Wuhan Asia Heart Hospital converted from a for-profit model to a non-profit one in 2006, while Fosun required the Suqian Zhongwu Hospital to convert its model from non-profit to for-profit as a prerequisite in its acquisition of the latter.

Investment in hospitals in China is just starting to gather pace and is a sector equally full of opportunities and challenges. Investors and hotel management groups need to carefully consider all the above-mentioned factors and select the most appropriate business model so as to maximise returns and minimise the risks. Eb

***L.E.K. Consulting** is a global management consulting firm that uses deep industry expertise and analytical rigour to help clients solve their most critical business problems. Founded more than 30 years ago, L.E.K. employs more than 1,000 professionals in 22 offices across Europe, the Americas and Asia-Pacific. L.E.K. has been on the ground serving clients in China since 1998.*

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