

Investing in China's private healthcare system

April 2013

Highlights

Reform in China will expand healthcare for citizens and allow foreign investors a bigger role to play.

Since the public health sector lacks some critical resources, private money can play a big part.

Five growth areas in the market are especially ripe for entry.

Successful strategies include choosing the right local partners and markets.

China's fast-moving healthcare sector is more inviting than ever for foreign investors, as the government has committed to easing ownership requirements.

In the past, a healthcare provider needed a minimum of 30% Chinese ownership; now, 100% ownership is allowed for investors from Hong Kong, Macao, and Taiwan in some areas.^{1,2} Other foreign investors can participate but are subject to different local standards, such as 90% foreign ownership permitted in Chengdu.³

The bold move lays bare the demand for better healthcare services as China's economy expands. Residents are living longer and getting richer, which is upping the demand for healthcare. And the aging population and the rise in chronic conditions add stress to a system that already faces constraints on supply, like overcrowded hospitals and a limited number of doctors and nurses.

This combination of door-opening reforms and strong healthcare demand creates a burgeoning market for investors.

Positioned to prosper

1. In the past 30 years, China has gone from an exclusively government-run public healthcare system to one that is decentralized and open to private and foreign investment.
2. Private businesses own an increasing number of the country's urban outpatient clinics, though only 12% of China's hospital beds are private. Their participation in healthcare will probably grow. For example, in 2011 investors built 1,372 private hospitals, bringing the number to 8,440.⁴
3. The Chinese government pledged to give private capital priority consideration for establishing new healthcare facilities.

¹ Ministry of Commerce and Ministry of Health (2010), *Interim measures for the administration of Taiwan service provider establishment of sole proprietorship hospitals in the mainland*, No. (2010) 110.

² Ministry of Health and Ministry of Commerce (2012), *Expand the geographical range of the Hong Kong and Macao service providers to set up wholly-owned hospitals in the Mainland*, No.19 [2012] of the Ministry of Health.

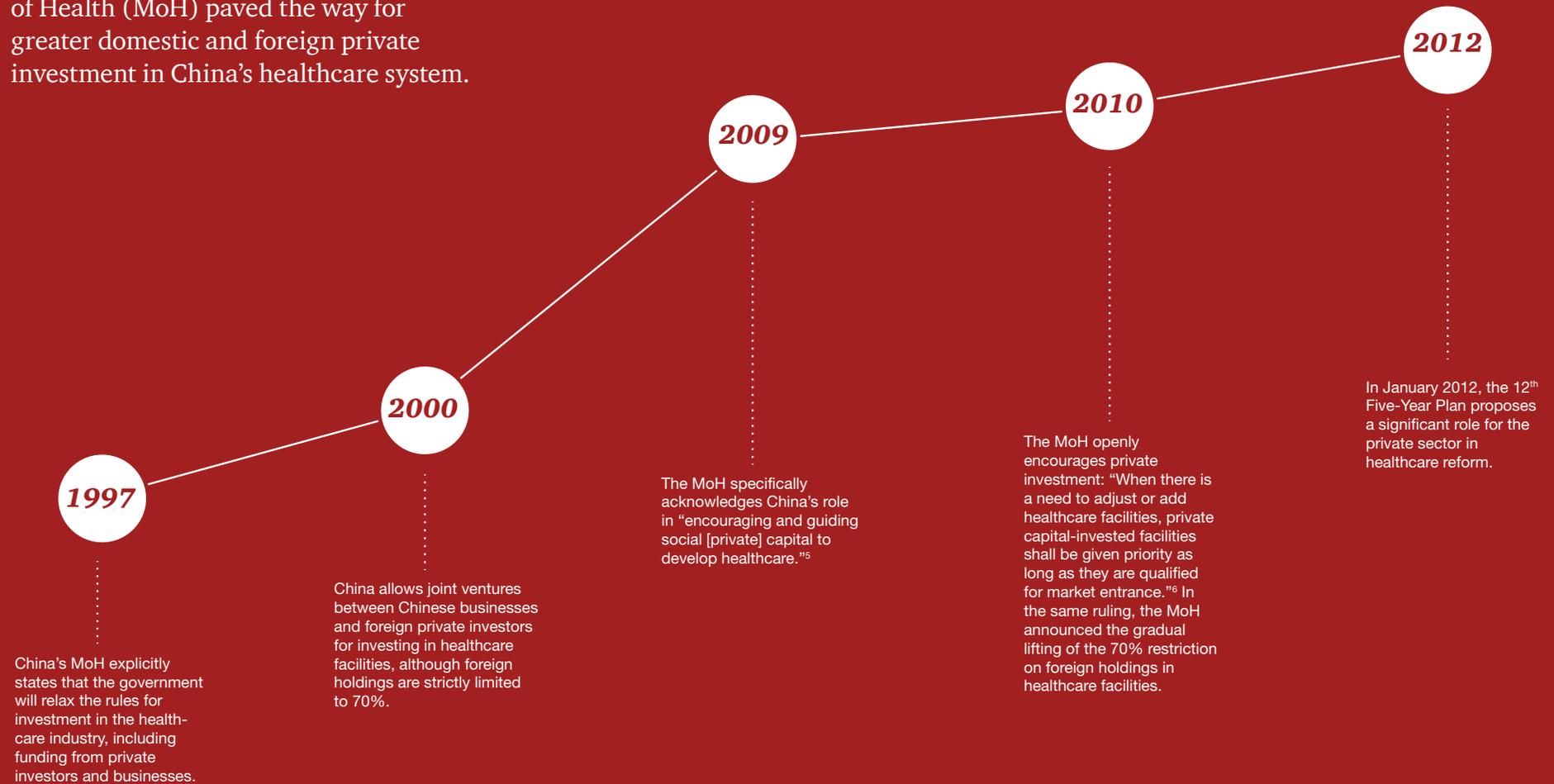
³ Sichuan Province Health Bureau and Sichuan Province Commerce Bureau (2012), *The notice on the issuance of measures for the administration of Sino-foreign joint venture and cooperative medical institutions in Sichuan Province*, No.146 [2012] of the Sichuan Province Health Bureau.

⁴ *China Health Statistics Yearbook 2012*.

At a glance

Path to privatization

A series of rulings by China's Ministry of Health (MoH) paved the way for greater domestic and foreign private investment in China's healthcare system.



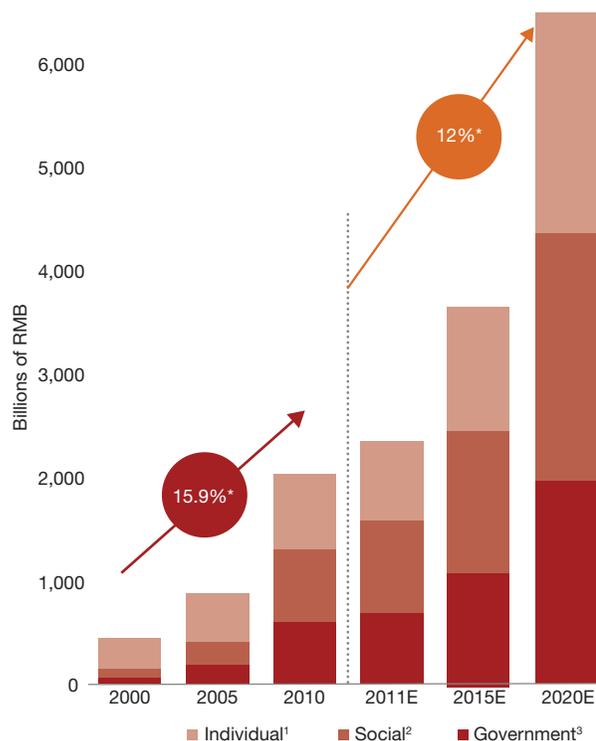
⁵ The State Council Health Reform research, *Optimizing conditions for private healthcare to further public hospital reform*, p. 9. Prepared by The China Centre for Health Economic Research, Guanghua School of Management, Peking University. October 9, 2011.

⁶ National Development and Reform Commission, Ministry of Health, Ministry of Finance, Ministry of Commerce, Ministry of Human Resources and Social Security, *Opinions on further encouraging and guiding social capital to invest in healthcare institutions*, p. 1-2. November 26, 2010.

Better care, bigger opportunities

Healthcare spending—and funding—continues to rise

China healthcare expenditure by source of funding



*Compound annual growth rate

¹ Personal expenditure

² Social medical insurance

³ Government spending and subsidies

Source: China Health Statistical Yearbook 2010, P.R. China, WHO database, PwC market research

As the government advances China's healthcare infrastructure, it's creating vast opportunities for the private sector. By addressing the growing healthcare needs of middle and upper-class Chinese, privatizing could potentially raise the standards of care.

Progress is already happening: China now provides basic medical coverage to 97% of its population. So far, China's healthcare reforms have decreased individuals' share of out-of-pocket payments for healthcare services from 60% of total costs in 2001 to 35% of total costs in 2011.⁷

Now, the government has renovated or improved 2,200 county-level hospitals and 33,000 grassroots healthcare facilities to address unequal access to care across the country. As a result, outpatient visits to all healthcare facilities have increased 28% since the start of the reform effort in 2009.⁸ With the marketplace still growing, it's a prime opportunity to explore investment strategies.

Now open for investment

The regional transformations and pilot projects of the 2009 reform program will continue through China's 12th Five-Year Plan (2011 - 2015), which will increase financial investment and government subsidies of insurance programs.

China intends to develop non-public healthcare facilities, encouraging enterprises, charities, foundations, commercial insurers, and foreign investors to organize healthcare institutions.

⁷ China Health Statistics Yearbook 2012.

⁸ 12th Five-Year Plan.

In particular, China is targeting lower-level facilities by improving county-level hospitals—especially in women's and pediatric specialties. And the country is aiming to build city-level general hospitals in remote areas as well as develop rehabilitation and long-term care facilities. The plan also proposes training clinicians, aiming to produce 150,000 new general practitioners.

Some regions stand out as especially appealing options for investors. Specifically, Hong Kong, Macau, and Taiwan received special preference from the government. Hong Kong and Macau can form wholly foreign-owned enterprises in direct-control municipalities and provincial capitals as of April 2012, and Taiwan is allowed five areas as of 2010.^{9,10} Taiwanese chain Landseed International Hospital is one notable example in Shanghai.

The government hopes its openness to foreign investment will create new competition between public and private facilities, driving efficiency in both. China also looks forward to increasing consumer spending power, with streamlined hospital processes and new international, improved healthcare standards.

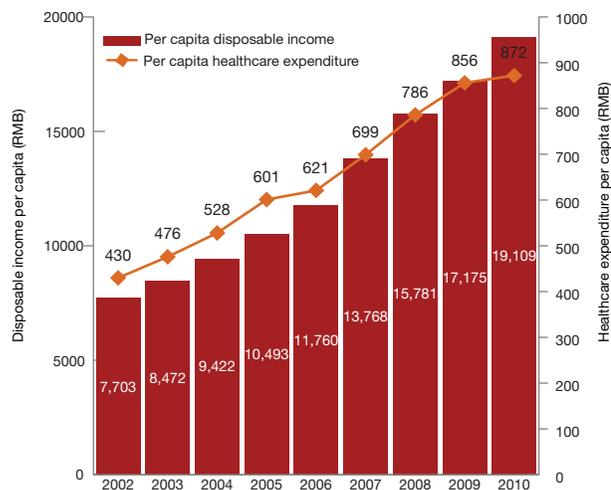
⁹ Ministry of Health and Ministry of Commerce (2012). *Expand the geographical range of the Hong Kong and Macao service providers to set up wholly-owned hospitals in the Mainland*, No.19 [2012] of the Ministry of Health.

¹⁰ Ministry of Commerce and Ministry of Health (2010). *Interim measures for the administration of Taiwan service provider establishment of sole proprietorship hospitals in the mainland*, No. (2010) 110.

How private money could transform the market

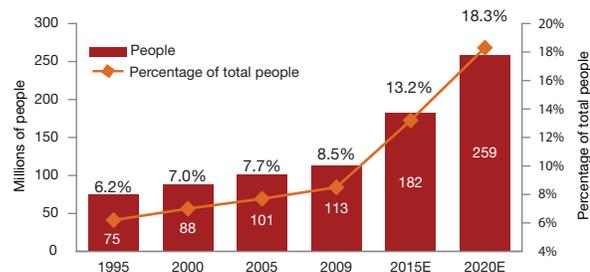
Spending more on healthcare

Per capita disposable income and healthcare expenditure of urban households, 2002-2010



A growing elderly population

Number of people aged 65 and above



Source China Health Statistical Year Book 2010, P.R. China, WHO database, PwC market research

China's private healthcare industry might be limited now, but the private sector is ready to take advantage of opportunities.

Private facilities will add competition into the marketplace and offer care alternatives to the middle and upper classes, making them an attractive potential investment. Large urban hospitals with more than 1,000 beds enjoy a lot of the country's resources and medical talents, as they're overwhelmingly the preferred care provider, but their overcrowded state is both a symbol of China's success and a symptom of deeper system issues.

Four shortcomings in the public sector

- 1. Staff shortages.** China has 1.8 physicians and 1.7 nurses per 1,000 people; comparatively, the US has an average of 2.4 physicians and 10.8 nurses per 1,000 people.¹¹ And the average qualifications of China's medical staff are relatively modest, with the majority of physicians and nurses lacking tertiary qualifications.
- 2. A weak primary care system.** The Chinese self-refer to specialists, so acute care facilities end up treating minor discomforts such as colds.
- 3. Overuse of services.** Most service reimbursement is still done in a fee-for-service system, which encourages prescriptions of unneeded services and drugs. Also, self-referring leads to the inefficient overuse of resources.

- 4. Overcrowding and few high-quality step-down care facilities.** These facilities offer restorative care for patients with moderate conditions who need medical, nursing, and rehabilitation services. Because there aren't many qualified step-down care facilities, Chinese acute-care hospitals keep patients longer than many of their Western counterparts. In 2011, the average length of stay in an acute-care hospital was 12 days.¹²

Breaking in: Investment options abound

Foreign parties can invest in ways that range from management contracts to joint ventures with local public or private entities. Investors sometimes reach full-scale privatization of certain public hospital assets, and new hospital development opportunities abound.

For example, the Beijing United Family Hospital is the first foreign-invested hospital in China. It was created in 1997 by Chindex, a publicly traded American healthcare company that provides Western healthcare services and products to the Chinese marketplace.¹³ Although small, United Family plans to increase its service offerings and its number of beds.

Another area for investors to explore: Chinese parties that seek foreign partnership association with US or European academic medical centers. They want to pair up to gain expertise in advanced clinical care, new models of care delivery, research, and teaching. A major US university hospital is currently in the planning phase of such a partnership.

¹¹ China Health Statistics Yearbook 2012.

¹² Ibid.

¹³ Chindex Calendar Year 2011 Annual Report.

Five frontiers where growth may boom

Where investments could pay off

GDP per capita range by province



Source: China National Statistics Bureau

The 12th Five-Year Plan points to growth areas in China's healthcare industry that investors can explore:

1. Primary care: The Chinese government plans to train 150,000 general practitioners by 2015 and promote health management contracts between practitioners and families.¹⁴ But first, providers must figure out:

- How to build a solid system when consumers are used to self-referring to specialists
- How to create an integrated system with downstream secondary and tertiary providers
- How to stay financially afloat without overreliance on pharmaceutical drugs, tests, medical supplies, and device revenue

Before China widens its practitioner base, a different category of players will make up the gap: Check-up clinic chains will expand beyond diagnostics and offer health management services to corporate and individual clients.

2. Rehabilitation and long-term care facilities:

To provide the right care at the right place at the right cost, China encourages establishing a step-down care system, but this poses challenges in the current fee-for-service environment. Facilities need to determine how to source patients from public hospitals. And they'll have to attract, train, and retain scarce therapists, nurses, assistants, and social workers—the backbone of a good step-down care facility.

3. Hospitals: Many business models exist, ranging from management contracts to joint ventures with local, public, or private entities to wholly foreign

ownership of new and existing facilities. High-end hospitals have strengths and shortcomings that are distinct from mass-market hospitals. A provider's success depends on finding the right model while considering risk, the investment location, and its skills and expertise.

Although medical practice liberalizing in 2009 allowed physicians to practice in locations outside their primary hospital, primary employers are typically unwilling to approve multi-site practices. And top public hospital physicians don't usually depart to go private, leaving private hospitals understaffed. To overcome this, investors can bring in retired public hospital physicians or import physicians from abroad. Financial, non-financial, and performance-based incentives must be created to attract top providers and create a distinctive culture.

4. Technology: Given China's size and the shortage of well-trained physicians, telemedicine and remote patient monitoring can help bridge the gap in healthcare by offering patients better access at reduced costs. These tools also allow providers to broaden their reach; increase space to care for acute patients; and partner with lower-tier facilities.

5. Information systems: The government aims to establish standardized health records for at least 75% of the country's residents, and standardized management of at least 40% of people with high blood pressure and diabetes by 2015.¹⁵ IT is considered key to better clinical care coordination, hospital management, and public health and resource management.

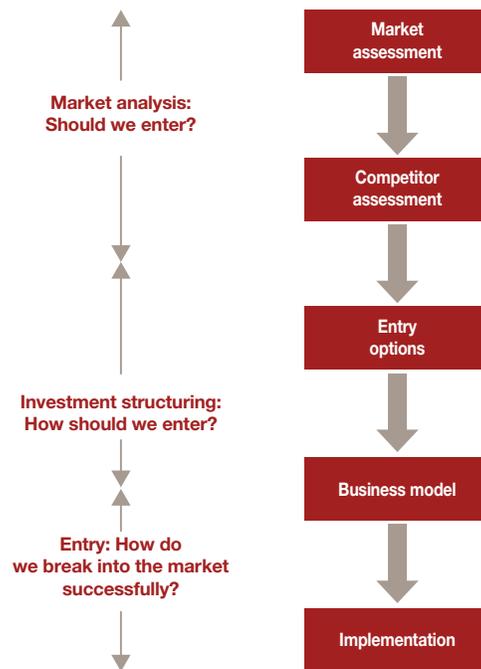
¹⁴ 12th Five-Year Plan.

¹⁵ Ibid.

Finding success as a foreign investor

Strategy to enter the market

Five aspects to consider



No matter which subsector foreign investors look into, they need to consider the nuances of China's business culture and healthcare system.

Study the intricacies of the market. Each geographical market in China has different politics and dynamics, and each specialty falls under different public and commercial insurance coverage rules and government regulations. Local partners who examine the business potential of possible markets often have an analysis that's too optimistic and inadequate for foreign business heads.

Have a unique international strategy. Foreign market entrants should create a strategy that uses their strengths and core values—one with a clear framework for evaluating opportunities. It is not enough to bank on the provision of better healthcare services, based on international standards for wealthy Chinese locals.

Pick the right partner. Although a wholly foreign-owned healthcare institution is now allowed, in reality you also need a Chinese partner to navigate complex licensing processes and build good government relations. Brand-name foreign investors are likely to encounter many partnership offers. So it's especially important to do due diligence: Select a partner or partners with similar culture, vision, and timelines to execute plans, and set clear roles and responsibilities.

Build a solid business and operating model.

For better or worse, most Chinese partners move quickly. They want to sign a letter of agreement before a business plan is created and build a facility before an operating model is vetted. Creating a target model that uses international leading practices and considers local constraints and customs will take time, along with building on-the-ground support. But a solid plan will help protect the most important assets that foreign investors have: their brand and intellectual property.

Look beyond the obvious. Avoid the wide-open areas that will have been quickly and successfully gathered by domestic players who know the system and have the connections. Foreign investors' strengths are in their technical and management know-how, with concerted planning, policies and procedures, standards, systems, and talent development—more difficult and time-consuming to form, but not easily replicated by local players.

How PwC can help

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