

Prudent Healthcare Investment in China

By

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Synopsis

In the last decade, the Chinese healthcare industry has been a focus of attention for international investors. This article provides a review of challenges existing in China that might be overlooked by most international investors and recommends several strategies and niches to minimize the negative effects.

THE CHINACARE GROUP

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It's an assumed truth that the Chinese healthcare marketplace represents an inviting investment opportunity for western investors seeking to get into the healthcare sector of this economy as it continues its present rapidly expanding and evolving growth into an economic power. In business capitals all over the world, healthcare executives are eyeing the large, underserved, Chinese population as an exciting opportunity to become established in the largest healthcare marketplace in the world. With its aged physical plants, inefficiencies, poor management and inadequate patient-service basis, China represents an opportunity for western companies to bring the skills, capabilities and knowledge gleaned over 50-years of growth and ever-increasing sophistication in the healthcare sector in the West to China and to realize extraordinary profits.

Or does it?

Let's look at some of the key assumptions being used to support this view. China has a Gross Domestic Product of \$1 trillion which grew at an annualized rate of 9.1% in 2003, 8.0% in 2002 and 7.3% in 2001. Clearly, this is impressive. China's population is becoming increasingly prosperous and wealthy with rising incomes reported in the major urban centers of Shanghai, Beijing and Guanzhou. Mobile telephone users number 282 million; automobile sales are almost 2 million vehicles a year (Buick estimates that it will sell more cars in China in 2004 than in the United States), internet users number more than 79 million and shopping centers in the major urban areas report brisk sales in luxury consumer items. Hospitals in China report huge demand for services and notable levels of profitability. This is despite their significant inadequacies in patient service, in computerization of processes and in management techniques. There is also a rising expectation from the public for improved services in hospitals on par with what that increasingly sophisticated public has observed in other countries.

These facts and statistics make an impressive case for China having evolved into a potential marketplace for international-level healthcare. Behind these obvious economic indicators are realities that are little understood and warning signs for the healthcare investor.

Despite savings that can be realized in construction costs, the total costs of building, equipping and staffing an international facility in China are higher than in most international environments. This is due to a number of factors including higher costs for imported medical equipment, for expatriate managers, for expatriate physicians, for imported medications, for architectural fees, for increased physical plant design issues and, for increased staffing levels. These increased costs will, when taken together, offset the lower labor costs found in China. Thus, it will cost as much, if not more, to open and operate an international caliber facility in China than it would in most international environments.

Unlike most international environments, however, the rate structure in Chinese hospitals has historically been set by the government without regard to realizing a return on capital. Such artificially low levels of hospital charges were necessary to be affordable to the average citizen but have now created an expectation of value or worth for healthcare services that is unrealistically low. There is little, if any, relationship between the actual costs of building and operating a hospital facility and the rates currently being charged. A typical Chinese hospital operating at 100% occupancy, 365 days a year, and charging normal rates is not capable of generating enough revenues to cover the interest alone on the capital involved in establishing the facility, much less paying salaries of staff, purchasing supplies, or operating the facility. The only recourse available to potential international investors is to set the charges for their facilities at a level which generates an adequate return on their investment in light of its associated risk

factors. While Chinese consumers in several independent surveys have expressed a willingness to pay 2 to 3 times more for hospital services in order to receive improved services, a hospital rate providing a reasonable return for the investment is estimated to be 15 to 20 times greater than currently charged by local hospitals. At this level there is significant consumer price resistance and only the most affluent Chinese consumers would consider themselves as potential patients.

This, then, is the challenge for international investors in healthcare in China. Providing a true international healthcare experience requires a rate structure which limits the potential market to only the wealthiest members of society. This is a very competitive niche with limited growth opportunities. Is this an attractive investment scenario?

I think that the answer is a qualified “no, not at this time.” For most healthcare investments, the Chinese healthcare market needs to mature; rates at local hospitals need to rise and the public’s expectation about the value of the improved services they are demanding needs to become more realistic before international investors will be able to make an acceptable return on their investment in China. However, there are opportunities for international investment in healthcare in carefully selected niches which balance lower capital costs for construction and equipage with a rate structure providing a reasonable revenue base that would be acceptable to a broader spectrum of Chinese society. These specialty niches typically require less intense medical equipage when compared to a typical, full-service, general acute care facility or depart entirely from inpatient care and focus on the lower cost ambulatory care facilities which have rapidly evolved in the West. In either of these cases, an international investor can enter the Chinese marketplace with an acceptable return on their investment and await the market maturation which will inevitably occur.