

China Healthcare Services: Walk-In Opportunities

The recent SARS crisis has focused world attention on the healthcare sector in China and highlighted the inadequacies in the delivery of healthcare services to the general population. In this report, the first in a series dealing with healthcare in China, we explore the current healthcare delivery system and the potential opportunities for foreign investors. Subsequent reports will deal with other aspects of the China healthcare industry such as medical equipment, pharmaceuticals and biotechnology.

Overview

For most of its modern history, China has had a system of free universal basic healthcare that has been enormously successful in improving the health of its citizens. One UN study estimated that average life expectancy in China rose from 41 years in the early 1950's to 71 years by the late 1990's (see table below).

China's healthcare delivery infrastructure is similar to that in Western countries, with community clinics designed for primary care and preventive health services, district hospitals for secondary care and larger city hospitals for specialized diagnostics and tertiary care. However, in practice most Chinese urban residents simply bypass the clinics and go directly to large city hospitals for even minor problems, in the belief that the quality of medical staff and services is higher at the city hospitals. As a result, public hospitals tend to be overstretched while preventive primary health services are de-emphasized.

Basic healthcare in China is financed through either Labor Insurance, which covers employees and retired workers of state owned enterprises, or Government Insurance, which covers government workers and retirees and university students. In addition, the government also provides subsidies

to healthcare institutions, which allows even the uninsured access to healthcare at a reasonable cost.

Besides the public hospitals and clinics controlled by the health authorities, various branches of the government also own and operate healthcare facilities to service their own employees. Coverage under the insurance schemes is thus generally restricted to designated hospitals related to the industry or government sector of the employees covered.

Chinese Hospital Categories	
Public	Hospitals under the jurisdiction of the Ministry of Health or Provincial/ County Health Bureaus
Military	Hospitals under the control of the PLA/Armed Police and in military controlled areas
Government Ministry	Hospitals founded and managed by various ministries or state bureaus (e.g. Ministry of Posts and Telecommunications)
Private	Private and foreign invested JV hospitals
Education/ Research	Hospitals affiliated with medical education and research institutions (e.g. universities)

Source: CDS Information Services

Comparative National Health Indicators [^]							
	Life Expectancy	Infant Mortality*	Healthcare Expenditures		Healthcare Professionals*		
			% of GDP	Per Capita (US\$)	Physicians	Nurses	Dentists
OECD							
Japan	81.3	3.2	7.8	2,908	193.2	744.9	68.6
France	79.1	4.6	9.5	2,057	303.0	497.0	67.8
Canada	79.1	5.3	9.1	2,058	229.1	897.1	58.6
Spain	78.8	3.9	7.7	1,073	424.0	458.0	38.5
UK	77.0	5.6	7.3	1,747	164.0	497.0	39.8
United States	76.8	6.9	13.0	4,499	279.0	972.0	59.8
Hungary	71.5	9.2	6.8	315	357.0	385.0	42.4
Turkey	68.9	39.7	5.0	150	121.0	109.0	21.0
Asia (ex Japan)							
Hong Kong	80.0	2.9	2.6**	617	150.4	387.0	26.6
Singapore	78.4	2.5	3.5	814	162.7	492.1	28.9
South Korea	74.6	7.7	6.0	584	136.1	291.2	33.4
Malaysia	71.7	7.9	2.5	101	65.8	113.3	8.6
China	70.8	33.2	5.3	45	161.7	98.6	2.0
Thailand	68.8	n/a	3.7	71	24.0	87.0	n/a
Philippines	67.4	45	3.4	33	123.0	418.0	52.0
India	60.6	n/a	4.9	23	48.0	45.0	n/a

Source: WHO

[^] 2000 data or latest available

* Infant Mortality per 1000 pop.; healthcare professionals per 100,000 pop.

** % of GNP for Hong Kong

Healthcare System Under Strain...

The healthcare system has been under increasing strain due to the continuing structural changes in the economy. Restructuring of state owned enterprises, rural to urban migration, the growth of the private sector and the lack of developed private insurance schemes has all led to a growing number of unemployed, self-employed, and privately employed urban dwellers with no medical insurance. At the same time, the government has been reducing its subsidies and now only funds approximately 50% of hospital budgets, while the prices of basic hospital services remain regulated.

In addition, a growing upper and middle class has created a demand for quality basic and elective healthcare services. Such demand is especially acute from affluent one-child Chinese families, where, due to cultural norms and societal pressures, parents willingly spend enormous amounts on their children to give them every possible advantage in life.

The confluence of these factors has presented an opening for foreign investors and there are already a number of foreign medical and dental services joint venture operations in China. However, we believe that the market is still nascent and that the real opportunities for foreign investors in healthcare services are yet to come – and not necessarily where investment has been historically.

Private Sector Steps In...


Private healthcare services, with the encouragement of the government, have begun to flourish in China. There are now estimated to be over 1,500 private hospitals in the country, including 160 joint venture facilities, and over 5,000 private dental clinics. For the increasing number of people who can afford it, private facilities provide fast access to a better quality of service and often to services that may be unavailable through the public healthcare system (e.g. cosmetic surgery, preventive dental treatments, “Lasik” eye surgery, etc).

Foreign investors are allowed to participate in this growing industry through local joint ventures. Generally, such joint ventures require a minimum investment of RMB20 million with foreign ownership usually limited to no more than 70%. In practice, this effectively means that foreign investors must commit to a relatively large up-front investment, rather than testing the market first with smaller investments in just one or two small clinics initially.

In order for a joint venture to be approved, it must demonstrate benefits to the country’s healthcare system, such as by providing better healthcare management practices or alleviating the pressures on the public system. Approvals are required from both the Ministry of Health and the Ministry of Foreign Trade and Economic Cooperation and where appropriate, the State Administration of Traditional Medicine.

Joint Venture Hospitals

Foreign invested joint venture hospitals, with their Western trained doctors and standards, cater primarily to the expatriate community, Chinese citizens returning from abroad and wealthy local Chinese, as the services provided by joint venture hospitals are very expensive by local standards. For example, the average outpatient consultation in a private joint-venture facility in a large city such as Beijing or Shanghai costs approximately US\$80 versus US\$12-\$14 at a public hospital. That increasing numbers of middle class families are willing to pay this differential attests to the growing dissatisfaction with the public sector and to the willingness to spend on healthcare - and on children - in China.

JV Hospital Profile: Beijing United Family Hospital			
	Ownership:	90% - Chindex (US listed distribution/importer of medical equipment and suppliers) 10% - Chinese Academy of Medical Sciences	
	Opening Location:	1997 Chaoyang District, Beijing	
Services:		Facilities:	
✓ Family Medicine	✓ Internal Medicine	✓ Emergency Medicine	✓ OBGYN
✓ Physiotherapy	✓ Psychology/ Psychiatry	✓ Urology	✓ Dermatology
✓ Dentistry	✓ Orthodontics	✓ General Surgery	✓ Orthopedic Surgery
✓ 50 Bed Capacity	✓ Operating Theatres	✓ Neonatal ICUs	✓ Adult ICUs
✓ Nursery	✓ 5-Star Birthing Suites	✓ Clinical Laboratory	✓ Pharmacy
✓ VIP Suites	✓ Imaging/Radiology	✓ Outpatient Clinics	✓ 24 hour Emergency Room
Financial Results:			
US\$ 000's	CY2000	CY2001	CY2002
Revenues	\$6,015	\$8,779	\$12,963
% Growth	n.a.	46%	48%
Op. Income	218	476	536
Op. Margin	3.6%	5.4%	4.1%
% Inc. Growth	n.a.	118%	12.6%
Other Facilities:			
<ul style="list-style-type: none"> • Shunyi County Satellite Outpatient Clinic opened in 2002, providing family medicine, dentistry and pharmacy services • Shanghai United Family Hospital and Clinics to open in 2H03 (70% Chindex, 30% Changning District General Hospital) • Guangzhou United Family Hospital and Clinics planned for 2004 			

Source: Company Data, US Securities and Exchange Commission

Typically, joint venture hospitals offer a comprehensive range of inpatient and outpatient medical and dental services, including lucrative ancillary services such as pre- and post-natal courses offered in conjunction with the actual delivery services. As well as serving individual patients, JV hospitals will try to secure contracts as the designated service provider for multinationals and diplomatic missions in order to develop a steady stream of revenues. In addition, some large,

comprehensive joint venture clinics, such as WorldLink, are planning on offering inpatient services and opening inpatient wards, moving closer to a hospital model.

Due to the large requirements in terms of both capital and management expertise, there are very few foreign invested hospitals to date, the most prominent one being Beijing United Family Hospital. However, foreign investment is expected to grow in this sector and several joint venture hospitals are currently being planned or under development, including the US backed Beijing International Heart Hospital. The most likely foreign investment partners will continue to be large investors with medical expertise, such as medical equipment distributors, drug companies and foreign hospital chains.

Local JV partners are usually local hospital authorities and medical institutes due to their ties with the local healthcare community, including regulatory bodies and can prove to be invaluable allies both in getting the JV hospital operational and in warding off potential competitors. In fact, many local private hospitals are adjuncts to public hospitals, providing much needed revenues to the public health system.

Even with a good joint venture partner, hospitals are complex institutions, hard to run successfully, and this is no less true in China. However, the higher risks associated with establishing and operating a hospital in China does not necessarily translate into higher profit margins. For example, Beijing United Hospital, the most successful JV hospital in China, despite catering almost exclusively to expatriates, wealthy Chinese and corporate healthcare plans, had a net margin in 2002 of 4%, which is only in line with the average for successful publicly listed general/acute care hospital groups in the United States.

Selected Hospital Group Profit Margins		
	Net Profit Margin	
	CY2002	CY2001
Beijing United Hospital	4.1%	5.4%
Community Health Systems	4.5%	2.6%
Lifepoint Hospitals	5.6%	5.4%
Health Management Associates	10.8%	10.6%
HCA	4.2%	4.9%
Province Healthcare	5.1%	6.2%
Tenet Hospitals	5.2%	5.6%
Triad Hospitals	4.0%	1.0%
Universal Health Services	5.4%	3.5%

Source: EDGAR

Joint Venture Ambulatory Care Clinics

For this reason, we believe that the most profitable opportunities for foreign investors in the future will not be the large integrated hospitals, but in ambulatory care clinics geared towards the burgeoning middle class. As in the West, elective ambulatory service clinics are cheaper to build, cheaper to run, simpler to manage and provide higher margins than full-fledged general services hospitals.

Furthermore, elective ambulatory healthcare services are exactly the kinds of “products” that the burgeoning middle class is likely to begin purchasing. These include primary medical and dental care services as well as more “elective” services such as pre- and post-natal care, “Lasik” eye surgery, cosmetic surgery, orthodontic services, physiotherapy, etc. Many of these services, especially the basic healthcare services (e.g. annual check-ups), represent long-term and low cost recurring patient revenues.

Currently, most ambulatory care clinic JVs are in the primary medical and dental healthcare areas and tend to be large comprehensive facilities or specialized (e.g. dental, eye-care) chains. JV medical care clinics, like JV hospitals, typically provide comprehensive outpatient services and are targeted at the expatriate and wealthy Chinese markets, while JV clinics tend to also target middle class Chinese. Dental clinics have proven particularly popular, driven by the large demand for dental services - there is estimated to be only one dentist for every 50,000 people in China. Prominent examples of JV clinics are shown in the table below:

Selected Foreign Invested JV Health Clinics			
	Service	Foreign Partner Nationality	Locations
	Medical/Dental	Singapore	Shanghai
	Dental	Japan	Shanghai
	Dental	US	Beijing, Dalian
	Dental	Hong Kong	Beijing, Shanghai, Shenzhen
	Medical/Dental	Intl	Beijing, Tianjin, Nanjing, Guangzhou, Shekou
	Eye Care	Switzerland /Canada	Shanghai (3), Wuxi, Chongqing, Hangzhou, Nanjing, Chengdu, Kunming, Zhenjiang

Source: Company Data

In addition to these, Quality Healthcare (Asia) of Hong Kong has announced a joint venture to establish a chain of clinics to

offer dental, medical, pharmacy, physiotherapy and nursing home services in China.

Finally, there are even plans for JV clinics to provide specialty healthcare services such as cancer treatment. For example, US firm AmMed International (see GenRx Healthcare profile below) is planning to open centers in Shanghai and Beijing offering cancer screening/diagnosis (including PET scans and molecular fingerprinting), radiation and chemo therapy and counseling.

As with JV hospitals, the most likely foreign JV clinic partners are those with some expertise in the medical field already, such as medical services providers or medical equipment distributors.

Foreign JV Partner Profile: GenRx Healthcare	
	<ul style="list-style-type: none"> Wholly owned healthcare subsidiary of HKR International of Hong Kong
China Healthcare Subsidiaries	
	Locations: Beijing (5 clinics), Shanghai (1) and Shenzhen (1) Opened: 1999
Services:	
<ul style="list-style-type: none"> ✓ General Dentistry ✓ Periodontics ✓ Orthodontics 	<ul style="list-style-type: none"> ✓ Prosthodontics ✓ Cosmetic Dentistry ✓ Oral Surgery
Other:	
<ul style="list-style-type: none"> Affiliated with the University of Pennsylvania School of Dental Medicine Corporate clients include U.S. Embassy in Beijing 	
	Locations: Shanghai, Beijing, Guangzhou Opened: Shanghai to open in 2003
Services:	
<ul style="list-style-type: none"> ✓ Cancer Screening ✓ Genetic Counseling ✓ Molecular Oncology ✓ PET Scanning ✓ CT Scanning 	<ul style="list-style-type: none"> ✓ MRI Scanning ✓ Ultrasound ✓ Radiation Therapy ✓ Chemotherapy
Other:	
<ul style="list-style-type: none"> Affiliated with the Memorial Sloan-Kettering Cancer Institute Sister Company AmMed Hong Kong has one center in Adventist Hospital and one screening clinic JV with Quality Healthcare JV agreement with Shanghai 2nd Medical School/Ruijin Hospital JV MOU signed with Peking University Health Science Center 	
	Locations: 1 Clinic in Shanghai Opened: September 2002
Services:	
<ul style="list-style-type: none"> ✓ General Dentistry ✓ Cosmetic Dentistry ✓ Orthodontics 	

Source: Company Data

JV Clinic Profile: Worldlink Medical and Dental Centers

WORLD LINK MEDICAL & DENTAL CENTERS		Location:	3 facilities in Shanghai
		First Opened:	1997
Shanghai Centre Clinic	Hong Qiao Clinic		
✓ Family Medicine	✓ Family Medicine		
✓ Internal Medicine	✓ Internal Medicine		
✓ Pediatrics	✓ Pediatric Medicine		
✓ OB-GYN	✓ OB-GYN		
✓ Orthopedics	✓ TCM		
✓ Traditional Chinese Medicine (TCM)	✓ General Dentistry		
✓ Neurology	✓ Prosthodontics		
✓ Dermatology	✓ Cosmetic Dentistry		
✓ Laboratory	✓ Pediatric Dentistry		
✓ Pharmacy	✓ Orthodontics		
✓ EKG	✓ Oral Surgery		
✓ Radiology/ Imaging	✓ Pharmacy		
	✓ Laboratory		
	✓ Radiology/Imaging		
Specialty and Inpatient Center (planned for 2003/2004)			
✓ 5 Star Birthing Facilities	✓ Physiotherapy		
✓ OB-GYN	✓ Gastroenterology		
✓ Executive Health	✓ General Surgery		
✓ Orthopedics	✓ Pharmacy		
✓ Neurology	✓ Laboratory		
✓ Dermatology	✓ Radiology/ Imaging		
JV with Ruijin Hospital in Shanghai			

Source: Company Data

Some Caveats for Foreign Investors

Relationships With Local Regulatory and Municipal Authorities Key. As with many initiatives in China, while the regulations are national in scope, implementation is subject to local interpretation. Often, the JV's may be competing not only with the public healthcare system but also with private facilities partially owned by the local government or the public healthcare system.

Sensitivity to Cultural Differences. Cultural differences must be taken into account when considering the viability of a healthcare venture in China. To take just two examples:

- Traditional Chinese Medicine (TCM).** In the West, the use of medicinal herbs and plant extracts are considered folk remedies at best and are not generally recognized or endorsed by the medical community. In China, TCM is a full-fledged medical discipline, with a codified body of knowledge and research, regulated by the government and integrated with "Western" medical practices. Foreign investors must recognize this fact and accommodate TCM in their health services.
- Filial Piety.** As in many developing countries, the extended family is the norm and the younger generation is expected to care for the older generation in their old age. Consequently, geriatric institutions such as nursing and retirement homes will have a difficult time gaining acceptance. This will undoubtedly change in the long term, especially as the parents of one-child families reach old age, but this change in cultural attitudes will not happen for some years yet.

Underdeveloped Private Health Insurance Market. Private health insurance schemes are still in their infancy. Until they become widespread, the growth in private healthcare spending will be somewhat curtailed. However, the obverse is also true: the rapid reform of the health insurance system and the introduction of private health insurance schemes should spur rapid growth in spending on both basic and elective healthcare services.

Outsourcing Model Not Generally Accepted. The outsourcing of non-core hospital services, from housekeeping to diagnostic services, common in the West, is not prevalent and unlikely to expand very quickly in China. First, public hospitals make up a substantial part of their budget shortfalls by charging for expensive tests using new and costly equipment (e.g. CT scanners). Public hospitals are loath to give up this revenue source. Second, public hospitals are not driven primarily by bottom line concerns. Outsourcing entire functions and removing them from a hospital's P&L and Balance Sheet may not necessarily be attractive to hospital administrators, regardless of the cost savings. The limited outsourcing

opportunities that do exist revolve around providing services that hospitals wish to provide but may not yet have the capabilities to do so, such as certain diagnostic and treatment services (e.g. the cancer treatment clinics mentioned above). This will change in the future, especially as more private hospitals open and outsource their non-core services, but it will be some time until the market develops.

Ongoing Healthcare Reforms. The Ministry of Health has been introducing reforms to entice patients back to their public street/workplace clinics for primary healthcare services to alleviate the burden on the hospitals and on the public system in general. In addition, the recent SARS crisis has highlighted the inadequacies of the current system and moved the improvement of the country's public health-care system to the forefront of the government's agenda, at least for the moment. If this momentum is maintained and the government succeeds in its reform efforts, the public health system, with its lower prices, will be a much stronger competitor to the private healthcare services industry.

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