Silk road: Opportunities for foreign-owned health care clinics in China

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ABSTRACT

Hospitals and other health care providers are being squeezed by declining reimbursement and capitated revenues. As this happens they are looking to expand into rapidly developing and newly industrialised countries. This article will focus on the People's Republic of China as a country with opportunities for developing private hospitals and health care facilities.

As revenues for hospitals and other health care providers continue to be squeezed by declining reimbursement and capitated revenues, and as managed care organisations look for new markets in an increasingly competitive environment, this article suggests an approach that is slightly different from the usual fare of integrated delivery systems – MSOs, PHOs, and other entities devised to help providers cope with the 90s.

Within the last 20 years, certain industries in this country that faced consolidating or maturing markets were saved by expanding overseas into rapidly developing and newly industrialised countries. As a result of the newfound wealth and an increasing middle class in those overseas markets, consumers there were found to be eager to acquire quality products and services from the United States and other western countries that they hitherto did not have access to, or could not afford. The result has been that markets in Asia and Latin America are currently fuelling much of the global economic growth. Avon, Kentucky Fried Chicken and McDonalds are some examples of United States companies and their products reportedly enjoying success from their aggressive expansion into China.

It is believed that similar successes can be achieved by the hospital and health care industries facing tougher times in home markets. Indeed, aggressive United States and European health care companies are already venturing into markets such as Russia, China, Thailand and Mexico to capitalise on their rapidly expanding economies and to position themselves for long-term growth and profits. Of note is Pepsico's joint venture in Moscow with Columbia-Presbyterian HealthServices (a for-profit subsidiary of Presbyterian Hospital in Manhattan) (Stanley 1994; Felsenthal 1995). The joint venture, US Global Health, offers United States-style outpatient services through clinics in Moscow to 'member' patients who pay an annual membership fee for the right to use the clinic's facilities. Pepsico and Columbia-Presbyterian plan to expand US Global Health throughout Asia and Eastern Europe. In China, National Medical Care, Inc., a large provider of kidney dialysis services and a subsidiary of WR Grace & Co., is operating a hemodialysis centre in the city of Guangzhou and intends to expand further throughout China (*Extel Financial Limited Regulatory News Service* 1994). Singapore-based AEA International, which operates a global emergency evacuation service, has invested more than US$1 million in a 24-hour medical clinic in Beijing. Its partner in the joint venture project is Beijing Red Cross Society of China.

The strategy in these markets is simple – capture the growing number of wealthy to middle class consumers who demand medical care that exceeds the quality of care provided in their own countries and that approximates western standards. Although residents of those countries frequently have the option of using low-cost, state-owned medical facilities, patients must frequently endure third world standards of care, hygiene and service. In addition, for the large number of American, European and other expatriates living and working abroad, private hospitals would be the provider of choice.

This article will focus on the People's Republic of China as a country with opportunities for developing private hospitals and health care facilities.

Summary of the market

With a population of 1.18 billion that was isolated from the rest of the world for nearly half a century from the 1940s through the early 1980s, China has been described as one of the last great commercial frontiers. Following the 'open-door' and economic expansionist policies instituted in the mid-1980s, China has experienced double-digit growth that is expected to continue into the next century. A brief summary of some basic facts regarding China in relation to other western countries follows.

	China	United States	Germany
Population	1.18 billion	258.1 million	80.8 million
Population growth rate	1.1%	1.02%	0.4%
Land area	9.32 million km	9.17 million km	349 520 km
Labour force	567.4 million	128.5 million	36.8 million
Gross national product	$410 billion*	$5.95 trillion	$1.4 trillion
Annual growth rate	13%	2.1%	1.5%

* United States State Department estimate

Source: Central Intelligence Agency, *The World Factbook 1993*.

In recent years China has enjoyed a massive influx of foreign investment. In terms of trade, the United States trade deficit with China ranks second only to the United States trade deficit with Japan (*1993 World Almanac Book of Facts*). Direct foreign investment into China is anticipated to continue to flow at a rate of around $20 billion per year – the United States is the only other country that attracts more foreign investment (*Economist Intelligence Unit, Crossborder Monitor* 1996; Brauchli, Khan & Chen 1994). Although there has been some recent tension between the United States and China regarding the protection of intellectual property rights, the United States has reaffirmed its commitment to developing the economic markets in China through the signing of intellectual property agreements and other trade accords between the two countries, including an eight-point agreement to assist China's entry into the World Trade Organisation. Reciprocally, China has agreed to open its markets to more United States farm products and hold talks on permitting more United States telecommunications and insurance services (*Far Eastern Economic Review* 1995).

As a country's economy grows, so does its spending on health care. A study commissioned by the World Bank revealed that spending on health care rises by 1.4 per cent for each 1 per cent of growth in gross domestic product. The reasons stem from, among other things, longer life expectancies and the more expensive treatments required for diseases such as cancer and heart disease (Kuper 1995). However, the World Bank has advised governments to focus on providing basic clinical services and not on most forms of high-tech care. This will leave the more expensive high-tech care for private companies to offer.

Health care in China

In China, accessibility to health care can depend on whether the individual lives in an urban or rural area and on their occupation. As in other countries, the availability and quality of health care is generally better in urban areas than in rural areas.

Individuals who are employed by state enterprises or government work units receive health care benefits through specific state-owned hospitals that service a designated coverage area. Such hospitals will typically have standing-order care agreements with the enterprise or work unit to service its employees. Treatment by physicians is also done through such hospitals as most physicians are employed and paid salaries directly by the state-owned hospitals.

Payment for health care services is on a cost-reimbursement system where the government work unit or state enterprise reimburses the designated state hospital based on government-controlled rates. The employee is required to pay a portion of the medical expenses in the form of a co-payment or deductible. The portion that is paid by the employer on behalf of the employee is ultimately paid for by the government.

In order to obtain treatment, the employee obtains an authorisation voucher from the employer that is presented to the hospital upon treatment. These authorisation vouchers are issued by the hospital and distributed to state employers for use by their employees. For employees of joint venture companies, medical expenses are generally covered up to 50 per cent by social insurance. Self-employed workers are usually 100 per cent self-pay.

China is now experimenting with different health insurance mechanisms that will seek to provide health coverage to increasing numbers of the population that are not afforded health benefits because they are not employed by government units or rural communes. In developing these mechanisms the government also hopes to contain costs that have risen due to inflation and the increased use of more expensive treatments. Some state-owned hospitals in the city of Guangzhou are offering more sophisticated treatments on a fee-for-service basis as a means of subsidising the basic services it provides to the general population (Swanson, no date).

Using state-owned facilities can be risky. Patients complain of having to 'pay off' physicians and nurses in order to be treated quicker or to have the job done well. Failure to make such pay-offs can result in long waits and 'careless' service. One patient reported having to pay the anaesthetist moments before the operation to ensure a 'proper' job. In addition, many Chinese hospitals have the appearance of being old and dirty, in contrast to the bright, antiseptic look of western hospitals. Blood supplies are also of concern as screening is not done as carefully as in the West – Hepatitis C, for example, is not screened for at all (Richter 1993). For those who can afford them, western-style hospitals and medical treatment would be preferred.

The tremendous economic growth in China has produced a new class of wealthy entrepreneurs and business owners who are able to afford private medical care on a fee-for-service basis. Assuming that the top 1 per cent of the population is in that class, it would mean a potential domestic patient base of approximately 12 million people. In the large cities and provinces such as Beijing, Shanghai and Guangdong Province where much of the wealth is concentrated, the number of potential patients would probably comprise the wealthiest 5 per cent of the population. Given that their respective populations are approximately 11 million, 13 million and 70 million, the potential patient base in each of those areas would be 550 000, 650 000 and 3.5 million people respectively. As the economy continues to expand and a larger percentage of the population enters the middle class, that patient base for private health care will likewise expand at an increasing rate.

Higher-level government officials may also be attracted to such a facility where they can obtain western prescription medications that are superior to those provided by state facilities and are faster-acting than traditional Chinese herbal remedies that are sometimes prescribed.

The number of potential consumers for private health care would also include diplomatic personnel, executives and managerial employees of foreign companies travelling or living in China, as well as their families. In places such as Hong Kong, Singapore, Taiwan and Japan, from which American, European and other Asian companies conduct their trade with China, frequent travel to China is a necessity for business executives. Examples of large multinationals with operations in China include Allied-Signal, ARCO, Bechtel, Canon, Colgate-Palmolive, Control Data, Digital Equipment, Eastman Kodak, Fluor Corporation, General Electric, Hewlett-Packard, HJ Heinz, Johnson & Johnson, Motorola, Pfizer, Raychem, Rhone-Poulenc, Rockwell International, Sharp, Seagram, Sony, 3M, United Technologies, Toyota, Volkswagen and WM Wrigley (Gale Research Inc. 1994).

The Chinese Government estimates that the overseas diplomatic and business community in Beijing *alone* numbers over 10 000, and the number of foreign travellers in China numbers approximately 27 million annually (Ministry of Public Health 1989). For these individuals and their family members, a clinic with English-speaking physicians and standards of treatment comparable to those in the West would be the natural choice over state-run hospitals. By its own account, the Chinese Government states that:

> Medical and health care services...are far from able to satisfy the ever increasing requirements of foreign visitors. Conditions in hospitals which currently service foreigners are simple and crude and lack appeal (Ministry of Public Health 1989).

For Americans with health insurance coverage who are travelling or working in China, medical expenses incurred abroad are usually reimbursed by the health insurance plan directly to the individual for their out-of-pocket costs (less the amount of any applicable co-payment or deductible). However, the individual will be required to pay in advance for the services received (or before leaving the facility), which means that they must have adequate travel funds on hand. In addition, the individual is responsible for obtaining a properly itemised *and translated* bill for purposes of submitting a claim. On the other hand, if the hospital in China has a provider agreement with the health insurance plan, payment can be made directly to the facility without the need for prepayment by the patient. Facilities in China with such an agreement are extremely limited. For example, Blue Shield's worldwide list of participating hospitals is limited to one facility in Shanghai for the whole of China. (Blue Shield's coverage also requires that outpatient and physician services rendered overseas be prepaid by the insured, followed by submission of a claim for reimbursement).

The medical–legal framework

Wholly-owned and joint venture hospitals

On 10 February 1989 the Ministry of Public Health promulgated *Several Regulations on the Operation of Hospitals and Clinics for Foreigners and Overseas Chinese and the Practice of Medicine in China by Foreign Doctors*. The regulations state that foreigners may establish hospitals and clinics on a joint venture basis in pilot projects.

In negotiations on the General Agreement on Trade in Services (GATS), China has stipulated that medical and dental services would be 'unbound', that is, China would not be restricted in establishing its own trade restrictions in those service industries. Notwithstanding this position, however, China states under GATS that foreigners are permitted to establish joint venture hospitals or clinics with Chinese partners 'with a quantitative limit in line with China's needs.' Furthermore, the joint venture hospital or clinic will be solely responsible for its foreign exchange balances and its profits and losses. On the other hand, foreign *wholly-owned* hospitals or clinics are not permitted.

The United States Consul-General's office in Guangzhou, among others, has confirmed the position of both the central and provincial Chinese governments that the modernisation of health facilities is high on their agendas and that joint venture hospital partners are available for approval.

Responsibility for the examination and approval of contracts and articles of association for the joint venture hospital is with the Ministry of Foreign Trade and Economic Cooperation (formerly the Ministry of Foreign Economic Relations and Trade – MOFERT). 'Technical matters', such as preliminary project approvals and feasibility studies, are to be examined and approved by the Ministry of Public Health (MOPH). In addition, approvals from provincial governments having jurisdiction will be required.

With respect to charges for medical services, the regulations state that joint venture hospitals will not be subject to control and that charges can be determined in accordance with the principle of higher prices for higher quality treatment or with reference to international standards.

Medical staff

Under GATS, the requirement for the composition of physicians and medical personnel in joint venture hospitals and clinics is that a majority must be of 'Chinese nationality'. In order for foreign physicians to be employed by the hospital or clinic, the physician must be licensed in their home country, must possess at least five years of practice experience, and have a contract with a Chinese medical institution. Permission to practise is given by the health authorities at the provincial level and may be granted for up to one year.

A proposed model

The following model is suggested in connection with developing a health care clinic project in China.

Location

Initially, the project is suggested to be structured as an outpatient clinic to be located in one of the major metropolitan or commercial areas such as Beijing, Shanghai, Guangzhou or Shenzhen. (Shenzhen is a city in a 'special economic zone' that borders Hong Kong in which extensive commercial development has occurred.)

Services

Primary and paediatric care, and outpatient and ancillary services, including some ambulatory and cosmetic surgery, should be the main focus of the clinic.

- China's official 'one family, one-child' policy has made the child the focal point of the family, for whom additional expenditures for quality products and services are incurred.
- In addition, aesthetically enhancing cosmetic surgery such as breast augmentation is growing in popularity in the large cities.
- As patient flow increases, additional specialty services and high-tech equipment can be offered.

Staffing

Western-trained primary care physicians and interns would be a selling point and, therefore, should be recruited to staff the clinic. These physicians may be offered an equity interest or option as an incentive to relocate. Given the current business environment, certain specialists may also find such an offer attractive. Identifying bilingual, western-trained physicians who are willing to relocate to China should be possible in large ethnic Chinese communities such as Southern California.

Joint venture partner

It is recommended that a large local hospital be selected as a joint venture partner for the following reasons.

- Preferably, the local hospital joint venturer will already have an established name and reputation within the community or province that will lend name recognition and credibility to the new venture.
- The hospital joint venturer may be able to set aside space within the hospital complex to be used by the clinic and designated as a special treatment centre administered by western-trained physicians and with western standards of quality, service and hygiene.
- The hospital joint venturer will already have ties with government work units and foreign joint ventures for purposes of marketing the clinic's services to those organisations.
- A joint venture partner that has standing and influence in the province or municipality in which the clinic is situated should be able to reduce the amount of bureaucracy encountered.

Marketing

Suggestions for marketing the services of the clinic are as follows.

- The clinic should obtain provider agreements with United States health plans to cover, on a discounted fee-for-service basis, their enrollees who are travelling or working in China. One approach to obtaining contracts with health insurers could be on the basis of preventive care; that is, proper treatment at a reputable facility at the time when it is most needed will avoid costly treatments (and higher payments) later due to improper or incompetent care by a local health care provider.
- Membership plans with annual or monthly fees can also be established, entitling members to use the clinic on a discounted basis. Such plans can be marketed to companies in, for example, the United States, Europe, Hong Kong, Taiwan, Japan and Singapore, with offices or joint ventures in China at which expatriate managers or executives and their families are based. The American Clinic in Moscow is using this model. If the number of potential patients is large enough, taking a capitation payment may be considered, subject to insurance regulations.
- Government-owned companies and high-ranking government bureaucrats can also be approached to use the clinic. Government companies in China that are profitable will frequently use those profits to purchase western goods, automobiles and services to be used by their managers and employees. Those same companies may also be willing to incur expenses for health care in excess of what the state hospitals would otherwise charge where the level and range of services offered by the clinic are more appealing. For example, in addition to medical services, the clinic can offer health and nutrition counselling, physical therapy services and cosmetic surgery as services that may not otherwise be obtainable from state hospitals. If the number of potential patients is large enough, taking a capitation payment may be considered, subject to insurance regulations.

Expansion

As the clinic's business expands, additional clinics can be developed and a broader range of services offered. In addition, as the government is now moving away from government-subsidised medicine, there will be tremendous opportunities for health insurance-related products. Developing such products may be a logical extension to owning and operating a chain of clinics where quality and utilisation can be monitored and controlled. Where alternatives to contracting with other providers offering similar quality services would be limited, controlling your own provider network will be an important factor.

Exit strategy

If a point is reached when the foreign partner desires to exit from the venture, the following alternatives may be available.

- Direct buy-outs or investments by other foreign investors or capital funds is becoming more prevalent.
- Although a 'put' option may be negotiated with the hospital joint venturer to buy the foreign partner's interest at a certain price upon the occurrence of certain conditions, it is doubtful that the Chinese entity would be willing to pay a price satisfactory to the foreign investor.
- For successful and financially 'seasoned' ventures, going public in markets such as Hong Kong may be an option. The involvement of a reputable western entity as one of the partners could lend much credibility to the offering. Following a sale, the original foreign investor may be able to stay involved through a management relationship with the clinic(s).

Conclusion

The foregoing is intended to provide a general summary of the potential market for western-style health care services in China and to suggest a model for capitalising on the significant opportunities in that market. Bearing in mind that consumer health care spending in China is still far below that of western levels, however, the amount of capital invested should be limited to an amount that can reasonably be estimated to provide a favourable return over five to ten years. Health care projects currently being contemplated in China range in scale from US$5 million to US$50 million. It is believed that these amounts are far too high for a start-up project, given what the market can support at this time. It is suggested that new projects undertaken should be on a pilot project basis, with initial capitalisation of between US$1 million to US$5 million, and expansion to follow depending upon business conditions. As experience and an understanding of the system are gained, additional clinics may be established, which eventually may provide an entree to developing a health insurance-related product as discussed above.

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