CE9000 NETWORK NEWSLETTER

Opportunities and Pitfalls for Private Equity Investors on the GCC Playing Field for Acute Care Hospital Start-ups

30.07.2010

By Andreas A. Schoenwandt, MA, MBA

Opportunities and Pitfalls for Private Equity Investors on the GCC Playing Field for Acute Care Hospital Start-ups

By **Andreas A. Schoenwandt, MA, MBA**

Introduction:

The GCC member states have an unprecedented phase of growth and prosperity to look back on over the past fifty years. In large part, this growth was fueled by petroleum exports with its attendant need for imports of foreign technological innovation as well as heavy engineering and construction projects to expand the national revenue bases in the region.

Populations in the GCC member states have grown as economic activity increased, bringing in vast numbers of itinerant labourers as well as expatriate managers from all continents of the globe.

Population Mix:

Due to the aforementioned population growth in the GCC area, the issue of providing health care services on a country by country basis is diverse. Whether it be from health insurance to primary health care delivery access points in local communities, one size most definitely does ***not*** fit all, calling for a strict market segmentation in order to insure the efficacy of measures and appropriations made at the aggregated ministerial levels in charge of Healthcare.

Actuarial issues:

The 2009 shake-out in the construction industry after the collapse of financial markets in October of 2008 induced several players in the reinsurance markets to reappraise the new situation as an opportunity to review actuarial parameters for the insurance and reinsurance of GCC member populations, where itinerant labourers consistently pose significant challenges to modern health care delivery systems (due for instance to tuberculosis and hepatitis). Historically though, the high level of self-reliance of the different population cohorts in the GCC states have led to the adoption of traditional Asian forms of medical treatment in the absence of the breadth and depth of medical care many OECD economies have strived to develop and finance. Additionally, the issues of ***moral hazard*** (ex ante and ex

post) which are costly to mature OECD health care systems, play much less of a role in the GCC member states.

Expansion and Growth Strategies in the GCC region:

The GCC member states currently strive to recapture foreign disbursements in their Healthcare systems by increasing local capacities for acute care delivery at home rather than sourcing services for complex diagnostics and surgical interventions from abroad as was the case often enough over the past 30 years. The same should be achieved for other aspects of the Healthcare spectrum, while the sub-committee of Health Care Ministers of the GCC will likely seek ways to avoid cross-border overcapacities as they seek to maximize utility for their respective national health care budgets. Cost controls will be sought by using global budgets, DRG schemes as well as Capitation techniques. Optimal cross-border structures within the GCC member states for certain rare diseases are astonishingly similar to the "hub-and-spoke" queing strategies most often chosen by large hospital chains. More on this subject later as we discuss micro-economic decision sets.

"A" for Accountability and "B" for Benchmarking

Due to the increasing administrative sophistication encountered in the GCC countries, Master plans are being or have been worked out to better monitor and plan activities in the respective Healthcare sectors of the member states. The depth and breadth of these efforts allow the member states to compare and improve local efforts by allowing for reporting and monitoring according to OECD health care questionnaire standards. These standards by many measures achieve or aspire to surpass best-practice standards in OECD benchmark economies, not only in ex-post acute care but also in ex-ante health care (e.g. diabetes) awareness and prevention schemes launched in the near past so as to also better buttress nutritional consumer protection schemes within the member states as well. In the long run, certification and inspection standards will be implemented and supervised so as to better enforce ***pay-for performance*** pricing paradigms to be negotiated by the assigned national Healthcare Maintenance Organizations with their preferred service providers. This goes for acute care hospitals as well as laboratories, pharmacies and general and specialist practitioners. Market hygiene however dictates that as Healthcare systems in the GCC region mature, conflicts of interest will be best avoided by stipulating that national Healthcare "payers" no longer be allowed to provide competing services in mixed and privatized markets for primary, secondary and tertiary care.

Strategic entrepreneurial decisions before entering the GCC Healthcare market for acute care hospitals

What type of activities?

This question is best answered by the market segment one would like to serve, whether fully insured GCC citizens or private paying expatriate patients. Additionally, the business plans need to focus early on what type of medical staffing procedures will be offered or sought after: whether doctors and nursing staff will be salaried employees or whether a system of mixed employment models and/or reward and risk sharing between the hospital´s stakeholders and the physicians treating the patients should prevail. Special mention deserves to be made of the fact that private clinics by practicing physicians are increasingly looked upon with scepticism and are already being phased in some parts of the region.

What types of clinical activities offer lucrative opportunities for market entry and later expansion?

Cardiovascular diseases are by far the number one cause of death in the GCC region, followed by deaths from accidents, injuries as well as congenital abnormalities. The demographic profiles as well as future population growth expectations call for increased capacities in obstetrics and gynaecology as well. In addition, all areas of surgery (orthopaedic, visceral, cardiothoracic as well as oncological) are a must for any noteworthy presence to be established in the market for acute care hospitals in the region. Finally, the role of Internal medicine, while often misunderstood in mature OECD economies, plays a major role in the diagnostic process for "first-time" acute care patients with multiple disorders and language barriers and should be looked upon as a must for any new start-up with ambitions to becoming a top-tier player. Finally, the role of elective and cosmetic surgery will play an increasing role as the GCC member economies mature and offers lucrative marginal income to the bottom line of a hospital.

Private Equity investors would be wise to mandate their managers to seek out and negotiate cooperative agreements with secondary laboratory and diagnostics providers to insure quality and price stability in markets still short of well-trained technical staff. The same could be said for anaesthesia and radiology, whereas telemedical facilities organized along a "hub-and-spoke" system already provide opportunities for radiological services into remote areas or across different time zones, alleviating staffing problems on night shifts, etc.

What type of preferred "Feeder" system?

Aside from the seminal question as to the make-up of the types of medical services the hospital plans to provide to its prospective clients, the equity stake holders need to minutely source the enterprise´s revenue streams: Trade-offs between stable flows sourced by salaried practitioners in branded outpatient clinics or other types of less expensive but also less predictable private health care access points need to be carefully considered. It is also important to mark pre-arranged events as triggers for later contingency steps to be financed by the original business plan. Additionally, aggressive marketing with HMOs and insurers alike may lead to opportunities to contractually negotiate a preferred provider status.

What type of planning and construction paradigm?

Recent experience has shown that new and unconventional methods of designing, planning and construction for tertiary hospitals may save up to 50% of total construction costs. The savings would be wisely used for investments into top-notch world class standardized medical diagnostic, treatment and surveillance equipment as well as state-of-the art automated logistical and sanitary sterilization systems. This goes likewise for the HVAC (Heating/Ventilation/Air-Conditioning) planning elements, where utmost hygienic standards need to be deeply embedded in the early planning phases to avoid later sanitary problems. These and other considerations as well as other cost-saving ideas for kitchens, laundries and other elements of housekeeping may significantly reduce the probabilities of cost overruns and thereby reduce financial risk to the project.

What type of Management Information system (MIS)?

Successful enterprise architecture (EA) is an integral part of the overall planning process of which the design and construction of the hospital itself is but a single manifest element of an entire process. In keeping with the marketing principles of Philip Kotler as well as the enterprise theories of Michael Porter, the MIS must definitely be laid out to embrace the principles of activity-based costing. This approach allows better controls of operating and capital budgets and finally allows the management team to appraise each and every clinical specialty as a primary or secondary profit center within a product portfolio context which will then be subject to monthly reviews by top management. Needless to say, such transparency affords the additional charm of offering easy terms for valuing the entire enterprise and thereby adding to the margin of comfort of the equity stakeholders as an early warning system. Standard Enterprise Resource Planning (ERP) software offer excellent opportunities to mirror and map the entrepreneurial activities which then make up the MIS.

MIS and Human Resources (HR)

Modern MIS architecture allows for the integration of corporate services to be included and reflected in the overall EA. Within the MIS, the HR subsystem is one of the most delicate and important in order to establish and maintain high levels of staff morale and continuity wherever possible. Of immeasurable importance is the time and planning invested in creating and maintaining an anonymous “Critical Incident Reporting Scheme” which deserves to be debriefed to the commercial as well as the medical director of the hospital since staff councils play little or no role in the management of hospitals in the GCC region.

MIS and Corporate Communication (Internal and External)

Modern IT architecture allows for the combination of the protected intranet environment with platforms that allow Business-to-Business (B2B) as well as Business to Client (B2C) applications. If staffed accordingly, these platforms may generate excellent contribution margins to the overall bottom line or save costs by allowing released patients to make routine checks on delicate information contents (such

as blood tests, etc.) in a secure IT environment. Finally, the issue of corporate citizenship in the community should not be underestimated. Whether an enterprise is marginally or substantially successful is determined by hard as well as soft factors which create internal as well as public goodwill and most definitely add to the overall success of the enterprise. These factors include - but are not limited to - the respect for and observation of local customs, philanthropy and perceived professional outperformance through successful public relations and brand management.

Andreas A. Schoenwandt is a leading cross-border health care industry specialist focusing on hospital planning, construction and management as well as private equity advisory services. He is fluent in five languages (German, English, Latin, French and Spanish) and looks back on a long and successful career as an investment banker with Top tier American and European banks serving sovereign as well as corporate clients. A former student of the Deutsche Schule-German School in Washington, D.C., where his dad was an executive with Lufthansa German Airlines, Andreas has an MA from the University of Pennsylvania in Peace Science as well as an MBA in Finance and International Business from George Washington University in Philadelphia and Washington, D.C., respectively. Andreas enjoys the outdoor sports of hunting, fishing and blue water ocean sailing as his free time permits and shares his joy of history, reading and classical music with his family and friends.