



U.S. COMMERCIAL SERVICE, SHANGHAI

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# Privatization of Healthcare in the Yangtze River Delta

## Hospital and Elder Care Submarkets

September 2013



Now is the time to grasp the opportunities in China’s service industries. The dawn of China’s next great economic opening—the Shanghai Free Trade Zone—codifies the existing movement to a more open service economy. No industry in China is more appealing than the healthcare sector. For almost 130 years, Americans have been at the forefront of delivering state-of-the-art medical care to the Chinese public. Our country’s services and technologies are world class and our commitment to the well-being of the Chinese public continues today.

China’s healthcare sector is experiencing fast growth. The country’s increasing rates of chronic disease, burgeoning middle class, and aging population are strengthening demand for U.S. exports in medical equipment and healthcare services. As disposable household incomes continue to rise, this trend should continue to grow.

The affluent and populous Yangtze River Delta (YRD) offers a favorable business climate for American medical and health services companies. Privately owned hospitals and elder care institutions are increasingly being perceived as providing a higher standard of care. Local governments are encouraging private and foreign investment in response to citizen-driven demand and healthcare access needs.

The U.S. Commercial Service in Shanghai is committed to helping American companies find new international business partners in the YRD. This report analyzes the private hospital and elder care subsectors for those with a current or anticipated future presence in the YRD. Our research suggests that these submarkets are poised for dramatic growth despite some endemic challenges.

Sincerely,

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## Executive Summary

The world's most populous country is facing a health crisis. China's rapid socioeconomic and demographic transitions are presenting unprecedented challenges to the country's health system. The incidence rate of heart disease, strokes, diabetes, and chronic lung disease are surging, accounting for 80 percent of deaths and more than 70 percent of the country's health expenditures, according to a 2012 World Health Organization statement. Meanwhile, China's population is aging rapidly. By 2030, the number of Chinese aged over 60 is expected to double to 360 million. In Beijing, the country's leadership is also concerned that the disparity in healthcare accessibility, quality, and affordability is constraining domestic consumption and could lead to social instability.

To address these health-related national security issues, the central government has made healthcare reform among its top priorities. The government has spent over \$350 billion since 2009 to make healthcare more affordable for its 1.3 billion people. As part of the country's healthcare reforms, policies including the Opinions on Further Encouraging and Guiding Social Capital towards Medical Institutions (Circular 58) allow foreign investors to create for-profit and non-profit medical institutions in China. The country's 2011 Foreign Investment Industrial Guidance Catalog (2011 Catalog) has also removed some of the barriers that previously limited foreign investment in the medical sector, and now permits wholly foreign owned enterprises (WFOE) to establish medical institutions in the country. Furthermore, China's 12<sup>th</sup> Five-Year Plan (FYP), which runs from 2011 to 2015, provides the private sector with a supplementary role, with the aim of raising standards of care and addressing the growing healthcare needs of those who can afford it. Beijing hopes that by opening the country's healthcare space to foreign investment it can focus the country's limited resources on improving its healthcare delivery system and expanding medical insurance programs in the relatively poor rural interior areas.

Although veterans of China's private healthcare space are bullish about the industry's future, they warn of major challenges, insisting foreign operators and investors will not make a quick profit in China's nascent private healthcare industry. However, the combination of reforms, strong healthcare demand, growing middle-class and the aging population are creating growth opportunities for early entrants and a burgeoning market for those interested in China's private hospital and elder care submarkets.

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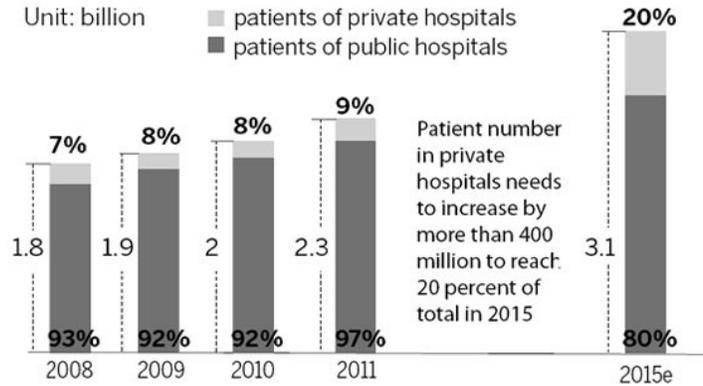
## Introduction

Representatives from the U.S. Consulate General and the U.S. Commercial Service in Shanghai recently examined China's healthcare reforms. To gain insight into the development of the private healthcare industry in the Yangtze River Delta (YRD), consulate officials interviewed over 40 local government officials, hospital and elder care administrators, venture capital fund managers, and physicians. Publicly available sources including Chinese government reports and speeches were also analyzed. This report offers guidance on what Americans can expect in terms of opportunities and challenges in the YRD's growing private hospital and elder care submarkets.

The primary objective of the country's healthcare reforms is to provide Chinese citizens with broad access to affordable basic health services. To date, the country's goal of providing universal health coverage has been largely successful—96 percent of the population has basic health insurance—but healthcare costs are quickly rising. Healthcare spending in China will almost triple to \$1 trillion annually by 2020 driven by an aging population and government efforts to broaden insurance coverage, according to a McKinsey & Company report.

The central government hopes to control its share of healthcare spending by allowing private operators and investors to enter the country's healthcare space. By doing so, the Chinese government hopes to classify the market and meet the different demands of the entire population. State-owned hospitals will eventually only offer basic and non-profitable services, while private hospitals and joint ventures (JVs), which offer better service but are more costly, will target the high-end market, according to Xu Su, vice director of the Shanghai Medical Reform Office.

## MARKET SHARE OF PRIVATE SERVICE IN CHINA'S HOSPITAL SECTOR



## FOUR MAJOR ENTRY MODES IN THE PRIVATE AND PUBLIC SECTORS HAVE BEEN OBSERVED SO FAR

Sources: MOH, China Health Statistical Yearbook 2012 and China Daily

Private operators and investors are encouraged to take part in China's health market. In August 2013, Premier Li Keqiang declared that the government will cut red tape and costs to spur foreign investment into the type of privately funded care that is common in the West. As a result, the number of private hospitals in China has increased by nearly 50 percent from 2008-2011, according to statistics from the former Ministry of Health (MOH). Private hospitals in China—which numbered 9,097 in June 2012—will continue to increase in number due to the government's ambitious goal to have 20 percent of the nation's hospital beds privatized by 2015. The central government would also like to see the number of private elder care institutions increased to provide institution-based care to 3 percent of the total senior population—approximately 3 million people—by the end of 2015.

Early and current healthcare operator entrants in the YRD have expressed great optimism about the upper-middle-class and affluent population's increased willingness to pay for premium health and elder care services. Despite being bullish about the future of China's private healthcare space, industry veterans warn of major challenges such as licensing, staffing, and obtaining land. Foreign operators and investors looking to make a quick profit were advised to reconsider entering China's nascent private healthcare industry where private hospitals and elder care facilities are underutilized.

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## The Rich, The Poor, and Burgeoning Middle-Class

China is home to one-fifth of the world's dollar billionaires and in 2013 is poised to become second only to the United States in terms of millionaire households. Notably, residents of the YRD are some of China's wealthiest citizens. Shanghai's urban residents, with an average disposable income of \$6,379, led the country last year, according to the Shanghai Statistics Bureau. This figure is almost double the national average in 2012 of \$3,912 for urban residents (9.6 percent year-on-year increase), according to the National Bureau of Statistics.

Although wealthy Chinese have household wealth that is comparable to their American counterparts, Chinese incomes still lag significantly behind, according to the 2012 China Household Finance Survey. Unfortunately, as the country becomes rich, income inequality is on the rise, and the vast majority of Chinese citizens cannot afford private healthcare. This may change in the middle-term, according to a McKinsey & Company report, which projected high-end and specialty medical institutions will continue to thrive, while general hospitals, both private and public undergoing privatization, will become key investment opportunities.

Although China's upper-middle-class and affluent population segments can afford private healthcare, typically, they seek treatment at Tier-3 or Tier-2 hospitals in large developed cities. Similarly, less-affluent patients seek treatment at community health centers where prices are considerably lower than private hospitals and clinics. To date, private healthcare institutions primarily offer services to expatriates and affluent Chinese who either have insurance coverage or can afford to pay high out-of-pocket costs, according to a Rubicon Strategy Group report. This is slowly changing, however, middle-class Chinese are becoming more aware of Western medical safety standards, customer services levels, and as a result, are willing to pay more for private healthcare. While a majority of foreign healthcare institutions in the YRD focus on serving high-income patients, a number of foreign healthcare operators have begun providing services to middle-class patients by signing management contracts with government owned specialized clinics.

Healthcare operators and investors looking to enter China's healthcare space should note that the country's public hospitals compete directly with private medical institutions and are categorized into three tiers. Tier-3 public hospitals are the most advanced and are normally located in large cities. These "provincial-level" hospitals usually have over 500 beds, VIP wards, and multiple specialized

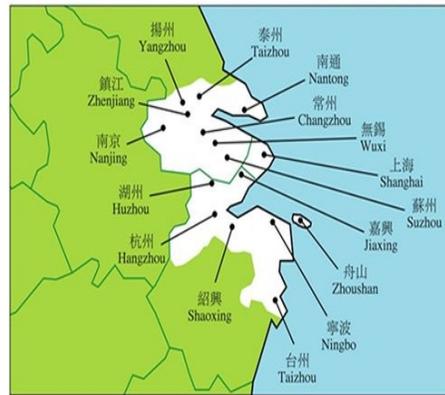
departments. Tier-2 hospitals are medium-sized “district hospitals” which include a number of specialized departments. Finally, Tier-1 hospitals are small “community hospitals” and are primarily used for preventive care for general health conditions.

**The YRD Economic Zone**



Source: <http://www.chinapage.com/map/map.html>

**The YRD Metropolitan Region**



Source: <http://china-trade-research.hktdc.com>

## Confidence Prevails Despite Major Challenges and Competitors

Professionals in the YRD’s healthcare community agree that now is the time to enter the private hospital and elder care submarkets, even if only to establish a foothold. However, they underscore the necessity of thorough due diligence, a long-term commitment to China, and making contact with the applicable government offices if companies wish to establish themselves in China’s growing private healthcare industry. Veterans stressed the need for boards of directors to be flexible and business plans to remain fluid, explaining that in China no tried-and-true business model exists for the private hospital and elder care submarkets.

The 2011 version of China’s Foreign Investment Guide, which became effective in January 2012, paved the way for changes in the healthcare industry, moving hospitals and other “medical institutions” (term not defined) from the “restricted” category to “permitted.” With the change, private and foreign healthcare providers were able to enter the industry at a rapid pace. Formerly known as the Ministry of Health (MOH), the National Health and Family Planning Commission is seeking foreign expertise and investment, and has ambitiously announced that by 2015, private hospitals will be managing 20 percent of the country’s hospital beds and inpatient and outpatient volume.

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Industry veterans, in addition to statistical evidence, confirm that the central and YRD governments welcome private investment. In May 2012, there were 8,947 private hospitals, almost 21 percent more than the year before, according to the former MOH. Over the past three years, more than 300 private hospitals have been approved in Shanghai alone, according to the city's Health and Family Planning Commission, who added since June 2013, private medical facilities are covering 6 percent of the city's health services.

Despite healthcare operators' wide-ranging estimations that 3 to 20 percent of the YRD population can afford private healthcare, profit has not come easy for most private medical institutions. Many hospitals, clinics, and elder care facilities appear to be suffering from "empty hospital syndrome." Private medical institutions should not expect that state-owned hospitals will refer patients to their institution. Public hospitals are subsidized by the government based on their inpatient and outpatient numbers. Therefore, it is not in a public hospital's economic interest to refer patients to a private medical institution. Despite this, referral agreements with other private medical institutions have been beneficial for recent entrants in the YRD. Gaining a reputation for high-quality care and integrity are vital to increasing overall patient volume, according to industry professionals. Industry veterans stressed, hiring well-known Chinese physicians is the cornerstone of success for medical institutions hoping to attract higher-income Chinese patients. When given a choice, Chinese patients are said to prefer famous Chinese physicians over Western doctors.

Healthcare operators and investors should not enter the market solely because private hospitals with long track records in China appear to be doing well on paper. Many of these hospitals have around 20 hospital beds, which they often struggle to keep occupied, according to industry veterans. American healthcare operators looking to export their services to China should remain cognizant that it will take time to create value in private healthcare services, and wealthy Chinese will need to lead the trend. Private healthcare operators uniformly agree that the rise of a large urban, affluent population will make up the majority of their patients in the next decade, a trend several well established private hospitals institutions in China have already witnessed.

In a sign of things to come, an American company is scheduled to open the first large scale U.S. joint-venture hospital in China in the fourth quarter of 2013. The 500-bed Tier-3 hospital will replace a 150-bed government owned hospital in a

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third-tier city in the YRD. The hospital will offer all major specialties and will serve public- and private-pay patients.

### **Politically Domestic but Commercially Foreign Competitors**

The *Cross-straits Economic Cooperation Framework Agreement* between China and Taiwan in 2010 allows investors from Taiwan to establish wholly-owned hospitals in Shanghai and Jiangsu province. The agreement also includes Fujian, Guangdong, and Hainan provinces. Similar agreements with Hong Kong and Macau allow the two Special Administrative Regions to set up wholly-owned hospitals in Shanghai, Chongqing, Fujian, Guangdong, and Hainan provinces. As a result, Shanghai Landseed International Hospital opened for business in 2012, becoming the first wholly Taiwan invested hospital in the Chinese mainland. However, Taiwanese hospitals like Landseed and BENQ are essentially empty according to executives working for private hospitals in Shanghai. Healthcare veterans in the YRD have said that other than speaking a common language and having firsthand knowledge of the Mainland China market, “politically domestic but commercially foreign competitors” do not have an advantage over American operators in China’s private healthcare space. China’s healthcare reform is still, however, 10 years behind where it needs to be, according to a senior-executive and veteran private healthcare industry professional working in the YRD.

With no change in sight for financial lending reform, wholly foreign owned medical institutions will continue to be financed through foreign loans, which put them at a disadvantage with Chinese institutions that are eligible for low-interest loans from Chinese banks. For this reason, even though the Chinese have given a green light to foreign investors and provided a fairly level playing field, only Taiwanese, Hong Kongese, and Macanese investors can easily open the door, according to industry professionals.

Nevertheless, it remains difficult for Taiwanese hospitals to compete with their counterparts in the Chinese mainland since Taiwanese hospitals are not covered by China's health insurance. Moreover, Taiwanese physicians are not allowed to transfer their license to practice medicine in China. While Taiwanese physicians need to pass all the necessary exams to practice in China, the Chinese government also regulates that a hospital needs to hire "senior" or "director-level" physicians for certain departments, positions which are only open to mainland physicians. These have become major problems that increase the cost of running hospitals in

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Mainland China for Taiwanese companies, according to a July 2013 *Want China Times* article.

## Country Profile



Source: [centurionhealthcorp.blogspot.com](http://centurionhealthcorp.blogspot.com)

In February 2013, then Chinese Health Minister Chen Zhu, called 2013 “a critical year” for health reform, Dr. Chen explained, there is now more expectation among the general public for better healthcare.

Increased urbanization, aging, and environmental degradation have brought about a rapid increase in the incidence of chronic disease and mortality. At present, about 260 million Chinese have been diagnosed with chronic diseases, as reported in China’s 2012 White Paper. State-owned Tier-3 hospitals are overwhelmed with heavy outpatient and inpatient workloads. This is contributing to popular discontent with China’s public health system and according to industry veterans pushing Chinese who can afford it to pay more for private health services.

To address its healthcare challenges, China unveiled an ambitious healthcare reform plan in April 2009 and committed to spending \$125 billion in three years, with the goal of ultimately providing universal health coverage by 2020. Today the Chinese government has largely achieved this objective, with around 96 percent of China’s population benefiting from broad but basic public healthcare insurance.

Consequently, the per capita payouts by the country’s insurance fund are skyrocketing and the rural population is bypassing rural clinics to visit urban hospitals. As a result, Tier-3 and Tier-2 hospitals located in medium to large cities are overwhelmed. Unfortunately for American healthcare companies, the vast

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majority of Chinese patients can only afford state-owned public hospitals and clinics.

To relieve some of the public hospitals' burden and offer high quality care for those who can afford it, Beijing has opened the country's healthcare market to foreign companies and investors. The Chinese government has moved medical institutions off the list of industries "restricted" to foreign investment and to the "encouraged" category in the country's 2011 Catalog. China's 12<sup>th</sup> FYP on the Development of Chinese Elder Care also encouraged private capital, including foreign investment, to take part in the elder care market. The government considers senior living communities the most suitable and acceptable out-of-home elderly care model in China. Retirement home facilities are targeted to provide 3 percent of the nation's nursing beds by 2015. The central government's goal is to add almost 3.5 million new elder care beds by 2017.

In line with this goal, China's 2011 Catalog categorized service institutions for the elderly as "encouraged," demonstrating the government's desire to encourage foreign investment in the social welfare sector and allow foreign investment to be made via a WFOE. However, in December 2012, the Chinese government issued an amendment to the law. Under the new notice, the WFOE model is "expressly opened" only for Hong Kong and Macau investors but foreign investment in a JV is still encouraged. However, the Chinese government released in June 2013 two draft rules on elderly care institutions in order to improve care for citizens age 60 and over. Drafted by the Ministry of Civil Affairs, the rules clarify standard practices for nursing homes and stipulate parameters for the establishment of elder care facilities, including items regarding the number of beds and professional staff facilities are required to have. The draft rules call for allowing both qualified organizations and individuals to set up nursing homes for seniors. County-level and above authorities are responsible for issuing such licenses. The draft rules also allow overseas institutions and individuals to set up nursing homes in China. However, for foreign investors, although they are allowed to set up WFOEs or JVs, licenses can only be issued by provincial authorities or entrusted municipal authorities. Aside from this exception, there is no explicitly stated restriction on foreign investment in "service institutions for the elderly," which falls under the "encouraged" category in China's 2011 Catalog.

Winston & Strawn LLP and Troutman Sanders LLP in their public reports conclude that China is relaxing restrictions and limitations on foreign investment in the

medical sphere on a limited and step-by-step basis. They believe that if the current round of liberalization does not cause unanticipated difficulties or opposition, healthcare operators and investors can anticipate further relaxation and more competition from foreign healthcare providers in the coming years.

## An Overburdened Public Healthcare Industry

According to the former MOH in March 2012, there were 1.5 times more public hospitals in China than private. Waiting times at public hospitals are estimated to be 30 times longer than private hospitals. Patients at famous state-owned Tier-3 hospitals often queue on average for four to five hours before seeing a physician for three to four minutes with little to no privacy.

**Statistical Comparison of Key Health Figures**

KEY HEALTH STATISTICS	CHINA	U.S.	JAPAN	WORLDWIDE
Hospital Beds / 10,000 Population	42	30	137	30
Number of Physicians	1,905,436	749,566	274,992	8,652,107
Physicians / 10,000 Population	14.2	24.2	21.4	14.2
<u>2000</u> percent of GDP Spent on Healthcare	4.60 percent	13.40 percent	7.70 percent	5.80 percent
<u>2009</u> percent of GDP Spent on Healthcare	5.10 percent	17.60 percent	9.50 percent	6.60 percent
<u>2000</u> Government Spending as percent of Healthcare	38.30 percent	43.20 percent	80.80 percent	57.60 percent
<u>2009</u> Government Spending as percent of Healthcare	52.50 percent	47.70 percent	82.30 percent	61 percent
<u>2000</u> Per Capita Healthcare Spending in US\$	\$43	\$4,703	\$1,974	\$106
<u>2009</u> Per Capita Healthcare Spending in US\$	\$191	\$7,960	\$3,045	\$292
Gross National Income per capita	\$7,640	\$47,360	\$34,640	\$6,965

*Source: WHO Global Healthcare Statistics: 2012*

Despite the claim made in China's 2012 White Paper, that it is becoming increasingly convenient to see a doctor and medical services are becoming more accessible to the masses, the general public has profound misgivings over the Chinese government's ability to provide basic healthcare in the event of a health crisis. This sentiment is one reason why the national savings rate is close to 40 percent of disposable income.

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China is facing a serious challenge from its aging population. The number of people aged over 60 reached 194 million last year, and is expected to top 200 million this year, according to China's Vice-Minister of Civil Affairs, who revealed these figures at the Second China International Senior Services Expo in May 2013.

A *China Daily* article recently highlighted the lengths one Beijing woman went through to find a bed for her aging father in a state-owned senior residence home. Reportedly, although she knocked on the doors of several institutions, including one of the best government-run nursing homes in China, the woman was told she would have to join a waiting list of several thousand. The university professor was quoted saying, "It would have practically taken more than 100 years before I could even think of admitting my father." The article underscores the reality that many Chinese citizens face when finding a bed at a senior residence home for their parents.

The concept of filial piety is alive in modern-day China. As a result, secondary caregiving is not the preferred option for those paying for or receiving elder care. Most Chinese only consider placing a family member in an elder care facility once that family member's medical requirements cannot be met at home, according to CEOs of elder care companies in the YRD.

The Chinese government will roll out preferential policies for private investors in industries that provide services to the aged, Li Liguo, Minister of Civil Affairs, announced in March 2013. Private investors in some regions will receive subsidies in addition to tax reductions to set up care centers and perform their daily operations. However, private elder care operators and investors should be aware that while the Chinese government is encouraging foreign investment, China's poverty levels for the elderly are high relative to the United States. According to the results of the China Health and Retirement Longitudinal study (2011-2012)—the first large-scale survey of Chinese over the age of 60, 22.9 percent—or 42.4 million—live in poverty on an annual income of less than \$523 a year.

Still, private elder care operators in the YRD are confident about the fledgling market's potential due to China's aging population. However, they advise caution, clarifying that the Chinese government is still developing its laws on private elder care and that people are not willing to pay for services they are not familiar with. Overall, the elder care submarket is still young and private elder care institutions remain underutilized like many private hospitals.

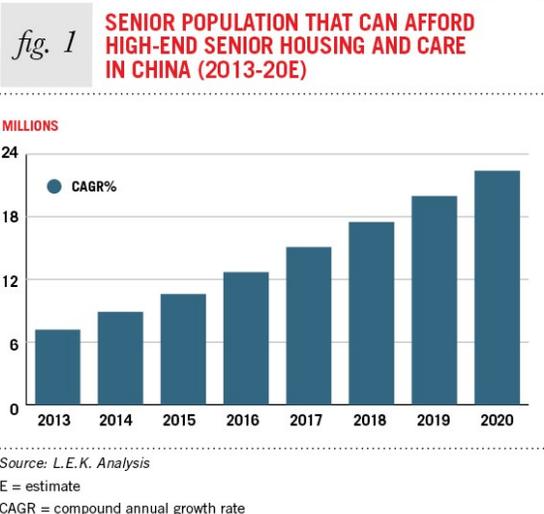
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## Consumer Spending Power

By 2022, McKinsey & Company predicts more than 75 percent of China’s urban consumers will earn \$9,000 to \$34,000 per year. This range is between the average income of Brazil and Italy in terms of purchasing-power-parity. Just 4 percent of urban Chinese households were within this range in 2000, but 68 percent were in 2012.

Although the Chinese are becoming more affluent, the country’s per capita gross domestic product (GDP) was just \$6,091 in 2012. In an article written by the Global Managing Director of McKinsey & Company, “China’s mass middle-class – with annual household incomes of between \$9,000 and \$16,000 – are dominant, accounting for 54 percent of all urban households; upper middle-class households, with incomes of \$16,000 to \$34,000, represent only 14 percent.” By 2022, the article predicts the mass middle-class will dwindle to 22 percent of urban households with the upper middle-class becoming the new mainstream, accounting for 54 percent of all urban households and 56 percent of urban private consumption.

The number of elderly who are able to afford high-end senior housing is expected to reach roughly 22 million by 2020, and seniors currently living in Tier-1 cities, which are China’s largest and wealthiest, account for approximately 10 percent of that total, according to L.E.K. Consulting.



Source: <http://www.chinabusinessreview.com/looking-after-chinas-elderly>

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## The Yangtze River Delta

The YRD metropolitan region, which includes Shanghai municipality, parts of Jiangsu and Zhejiang provinces, is the most economically advanced region in China and home to around 120 million people. Shanghai alone has 23.6 million residents.

As a result of China's continued economic prosperity, the standard of living has improved significantly in the YRD, fueling residents' awareness of the importance of personal health as well as their demand for quality healthcare services from both public and private healthcare providers. Chinese who have lived in Western countries are more likely to seek out private healthcare options than those who have never been abroad, according to professionals in the YRD's private healthcare industry. However, patient volume does not come easily. This is especially true in larger cities where Tier-3 public hospitals run VIP wards and private hospitals are plentiful.

### Income and Development Comparison Greater YRD & Mainland China

Admin. Area	2012 Mid-Year Population	2012 Per Capita GDP (USD)	2012 Per Capita GDP (CNY)	Domestic Per Capita GDP Rank (out of 31)
Shanghai	23.639 million	\$13,471	¥85,033	3
Jiangsu	79.093 million	\$10,827	¥68,347	4
Zhejiang	54.700 million	\$10,022	¥63,266	6
Mainland China	1.350 billion	\$6,091	¥38,449	--

*Source: Statistical Communiqué of the provinces on the 2012 National Economic and Social Development*

Americans often describe the YRD as an easier base for business because the provincial and city governments are friendlier towards Western business models than Beijing. Beijing officials are reportedly unwilling to meet prospective investors unless the project is valued at over \$50 million dollars. Health Bureau

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officials in Hangzhou, the capital of Zhejiang province, are described as progressive minded and more in tune with the health needs of the province's population. Similarly, Health Bureau officials in Nanjing, the capital of Jiangsu province, told U.S. Commercial officers that their city is very welcoming of foreign hospitals.

## Healthcare Sector

In March 2013, the former Shanghai Municipal Health Bureau announced that the city government is adopting new policies to encourage overseas private investment to meet the demand for medical services and further health reform. The city is promising what it calls "favorable policies" covering finance, tax and land, and is attempting to attract talented professionals with incentives including housing and children's schooling. American healthcare operators interested in establishing themselves in the YRD will need to carefully discuss with and seek applicable policy and subsidy support from the local provincial and city governments.

Chinese physicians are considered public-servants and are not accorded much respect in state-owned hospitals. Some are tempted to accept gratuities from pharmaceutical companies, patients or their families, and prescribe expensive and unnecessary medicine and tests to supplement their low pay. This is a reality described by entry-level physicians working at one of Shanghai's most prominent Tier-3 hospitals and the media in China.

The Shanghai Health Bureau's March 2013 announcement also indicated the city is encouraging social investment in the local health market, especially in elderly care, rehabilitation, mental health, pediatrics, obstetrics, and traditional Chinese medicine. Private hospitals offering these services were promised to have priority in being admitted to the medical insurance program.

American operators and investors should be aware that two medical districts are being created in Shanghai: the Pudong International Medical Center and the New Hongqiao International Medical Center. The new international medical centers will include several specialized hospitals which are under construction and are scheduled to start operation before 2015. The centers will work jointly with world leading hospitals and overseas medical groups, and along with local state-owned hospitals to meet the demand of the high-end market, according to Xu Su, vice director of the Shanghai Medical Reform Office. The vice director added, "We will also encourage local medical experts to open their own clinics in the shared facility

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center. Physicians will be encouraged to practice medicine in more than one health facility in line with international practices.” The Shanghai government is encouraging future private hospitals located in these areas to cater to high net worth patients since Shanghai’s city-level hospitals are scheduled to close their VIP wards by 2015 to focus on providing basic healthcare services.

#### **Shanghai International Medical Zone Master Plan**



Source: [www.perkinswill.com](http://www.perkinswill.com)

According to the municipality’s former Health Bureau, as of March 2013, Shanghai is home to 1,379 private medical institutions: 169 hospitals, 1,201 outpatient clinics, and 9 medical testing centers. Among them are 8 JV hospitals and 12 JV clinics. Of the 169 hospitals, only 5 have over 200 beds; 80 have 30 to 200 beds; and 84 have fewer than 30 beds. Very few of these are general hospitals and most specialize in gynecology or are specialist male clinics.

The oncology market in China is expected to be a core growth opportunity for foreign investors and operators. Shanghai’s cancer rate remains higher than the national average—cancer is the city’s second-biggest killer—with nearly 50,000 new cases and 30,000 deaths every year according to a February 2013 announcement by the Shanghai Center of Disease Control and Prevention. Officials announced the city’s cancer rate is more than 350 out of every 100,000 people, while the national rate is 285.91.

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One top public Tier-3 cancer hospital in Shanghai logs over 1.4 million outpatient and emergency visits per year, making it one of the busiest in China. The average wait time for a bed at the hospital is three weeks. The institution's good reputation and low cost, thanks to government subsidies, attract patients from well beyond the YRD who make up over three-fourths of the hospital's patients. Foreign oncologists working at a private cancer center in the YRD said many patients will only visit their center after becoming unsatisfied with Shanghai tertiary hospitals. Unfortunately, by then, patients are typically reported to have advanced cancers and are heavily pretreated. Despite Shanghai's high cancer rate, the oncologists described their center as "underutilized," but pointed out patient volume was picking up.

The oncologists also warn that it is difficult to obtain full disclosure from many Chinese patients. They said that during initial medical consultations, patients deliberately leave out important facts. They reasoned this may stem from a lack of trust or fear of offending their Chinese physician.

Provincial and city governments in the YRD have expressed interest in having foreign healthcare operators and investors establish elder care institutions that specialize in dementia care and rehabilitation. This sentiment was echoed by the China Council for the Promotion of International Trade in Hangzhou, which stressed hospice care is also needed.

Dementia affects 10 million in China, of which over 90 percent of dementia cases in the country are undiagnosed, according to a study published in the *British Journal of Psychiatry*. In June 2012, the Shanghai Industry and Commerce Administrative Bureau declared its support for foreign participation in high-end elder care services in Shanghai. It is now encouraging registration of both local and foreign commercial elder care services in the city's Pudong District.

The city's support for elder care is timely: in March 2013, Shanghai's Civil Affairs Bureau reported that the number of people in Shanghai 60 years or older was 3.67 million in 2012, accounting for 25.7 percent of the city's registered population. The number is predicted to rise to 29 percent by 2030.

The Shanghai municipal government envisions a "90-7-3" system, where 90 percent of the city's elderly receive home-based care from family or visiting nurses, 7 percent receive community nursing services at senior day care centers, and 3 percent pay for private senior facilities. Local governments nationwide have

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embraced a similar system. However, nearly 70 percent of elderly people in Shanghai would prefer their children to take care of them at home rather than rely on community services, according to a Shanghai Statistics Bureau survey published in 2013.

During the Shanghai International Forum on Senior Care in August 2013, it was announced that Minhang District will build the first senior nursing pilot zone in Shanghai. The *Shanghai Daily* reported the zone will have 10,000 specialized beds for seniors and will be completed around 2015. Currently, there are only approximately 620 nursing homes for elderly people in Shanghai with around 100,000 beds, according to Minhang District Party Secretary Sun Chao. Secretary Sun further explained that while the majority of senior citizens live at home, their children do not have the time to take care of them. Construction is scheduled to begin in the fourth quarter of 2013 in Huacao Town.

### **Industry Challenges: Private Hospital and Eldercare Submarkets**

Although foreign healthcare operators are eager to expand into China or strengthen their current presence, the lack of a clear regulatory environment and a trained workforce remain two major long-term obstacles for foreign healthcare operators. In the short-term, attracting a growing number of Chinese middle-class, upper middle-class, and wealthy will be a clear challenge when the majority of private healthcare institutions in China are not included in the national public health insurance reimbursement plan.

### **Licensing and Regulations**

Obtaining a license to open and operate a private hospital in China is a complicated and lengthy process, according to industry veterans. Foreign healthcare entities will need legal representation to help them navigate the licensing approval process. For information purposes only, the American Citizen Services unit in the U.S. Consulate General in Shanghai maintains a list of local law firms on its website.

The private healthcare sector has remained largely untapped due in part to a highly complex, local regulatory system. As the Chinese saying goes, "Where there is a policy from above, there is a repercussion from the localities." This means while the central government in Beijing determines China's laws and regulations, decentralization puts the implementation and enforcement in the hands of the

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provincial and city governments. This can lead to inconsistent interpretation and enforcement of national regulations from province to province and city to city

The permit process, according to foreign healthcare operators, can be lengthy or nearly nonexistent. For example, five Chinese physicians must be on staff at a hospital in order for that medical institution to be issued an MRI certificate. However, to be certified to have an accelerator—which has the potential to cause fatalities—medical institutions are only required to have one Chinese physician on staff, according to industry veterans.

Obtaining licenses for specific and necessary medical equipment can be a struggle for hospitals. In China, there are still regulatory hurdles that exist for obtaining the required licenses for the purchase and use of many necessary types of medical equipment needed to become a Tier-3 hospital. Healthcare operators who encounter trouble obtaining the necessary permits for medical equipment may be able to obtain assistance from large foreign medical technology companies.

Additionally, private healthcare companies should begin building relationships with the local government and relevant health and civil affairs bureaus before entering China. They should also begin negotiations towards subsidies and reimbursement agreements early.

Establishing clientele is a lengthy process in China, as it requires time to build a reputation and gain patient trust. Directly targeting wealthy customers may not be the fastest route to attracting their confidence and business. Word-of-mouth methods are often cited as the most effective marketing device to bring in patients. In addition, foreign invested medical institutions that are frequented by the expatriate population appear to simultaneously attract Chinese patients.

American elder care operators and investors should know the country's one-child policy has created a concept known as the "421" family structure in China. Once grown, the only-child is responsible for both parents and four grandparents. But the one-child policy and the migration of many young people to China's cities for work is changing the traditional approach of children caring for their elderly parents.

Chinese authorities recognize the importance of encouraging development of the private elder care industry along with dementia and hospice care. However, the laws regulating elder care institutions need to be significantly strengthened or

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developed, according to industry veterans. In the meantime, American elder care operators are forced to self-regulate and use U.S. standards. The director of the Research Center of Employment and Social Security wrote in an op-ed piece, “Though China’s 12<sup>th</sup> FYP has outlined the strong role that private and overseas investment can play in creating a mature senior industry and senior service system, the reality is far from that.”

Surveyed elder care operators in the YRD expressed their optimism but said the market’s profitability is probably 10 years away from being a sure bet. The general consensus is that the customer base first needs to familiarize itself with the standards and cost of private elder care in order to overcome comparing private options with government-run senior homes.

## Professional Staff

The biggest hindrance for prospective healthcare operators and investors in China is finding the right staff, according to senior executives in both the private hospital and elder care submarkets.

Private healthcare operators compete directly with public institutions for well respected, experienced Chinese physicians in their prime working years. A 2012 *Health Policy and Planning* journal article reported that 22 percent of the physicians in private hospitals are over the age of 60, whereas this figure in public hospitals is less than 3 percent.

With Chinese consumers often putting reputation ahead of quality of service, hiring famous Chinese physicians is important to attracting patients in China. A healthcare consultant and physician in Shanghai said private healthcare institutions’ marketing priorities should be based around bringing in big name physicians from famous Chinese hospitals like Peking University First Hospital in Beijing or Hengshan and Ruijin Hospitals in Shanghai. The likelihood of unknown private hospitals starting from scratch and attracting the necessary Chinese physicians is quite low. For this reason having a local partner may make sense for American private healthcare companies, unless they are an internationally renowned healthcare institution. Chinese patients typically only want to see the most respected Chinese physician available, according to Western physicians in the YRD. The preference reportedly does not change even when Mandarin speaking Western physicians are available or a medical institution has bilingual nurses on staff for translation.

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The former MOH revised a rule under the Medical Practitioners Law in 2009 permitting Chinese physicians to work at more than one medical institution. However, physicians must obtain the permission of their primary hospital and obtain the required certificates from their city or district-level health bureau before practicing at multiple locations. Home institutions have been known not to approve requests unless the physician is an established senior physician or department chair, according to a *Caixin* article. Despite private institutions offering higher incomes and more manageable workloads, the approval process has essentially left most physicians unwilling to leave their public institution or limiting their time to moonlighting because they are already overworked, according to Chinese physicians interviewed in the YRD. As a result, Chinese physicians working in the private sector are typically either recent medical school graduates or retired physicians from public hospitals.

Physicians who make the leap to the private sector often find climbing the professional ladder difficult. The Vice Secretary of China's Hospital Association told *Caixin* that a group of medical directors recently returned to the public sector after not being elected to the Chinese Hospital Association. On the surface, physicians who work for private hospitals are not excluded from these types of industry associations, however in reality, members are only chosen from public hospitals. The idea of starting from scratch and the fear of becoming an outcast from the traditional Chinese medical community is often enough to dissuade a Chinese physician from leaving the public health system, according to the CEO of a private hospital corporation in China.

Retirement benefits are also a source of consternation for physicians considering leaving the public health system. Physicians working in public hospitals can expect to receive 80 to 90 percent of their salary after retirement in the form of a pension. Although salaries are higher at private hospitals, according to some physicians, total income is often less than the "grey income" they can receive in public hospitals.

When one specialist in a public hospital in Shanghai resigned to join the private sector for professional reasons, news of his departure quickly spread through China's healthcare sector. "It is not easy to leave a state-owned hospital, especially for a senior doctor like me," the physician was quoted as saying in the *Shanghai Daily*. "I got through the most difficult period and started to enjoy a high professional position and income, compared with younger doctors."

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Attracting and keeping healthcare professionals in the elder care submarket is also challenging. China has a severe shortage of elder care professionals. Millions of nursing home employees are needed to care for the country's growing elderly population, industry experts say. Many Chinese avoid the profession because of the heavy workload, low pay, and social stigma attached to it. Relative to trained workers, the Chinese government needs to match its efforts to increase the number of primary care clinicians with similar efforts to expand the number of trained geriatric physicians, nurses, and vocational workers, according to a *China Daily* article in October 2012.

Experienced elder care operating officers in China are almost impossible to come by, according to the president of a venture capital fund who interested in entering China's elder care submarket. "It is extremely difficult to find someone who not only speaks English and Mandarin, but also understands both Western and Chinese cultures and is knowledgeable in the healthcare industry." Top candidates can reportedly demand a six-figure U.S. dollar salary.

According to government estimates, China needs 11 million caregivers to care for the 33 million elderly with various disabilities. This gap is creating a significant challenge for China and offers a good opportunity for foreign training companies. However, the lack of currently available trained staff is a serious bottleneck handicapping the progress of the elder care submarket. Moreover, China does not have enough elder care physicians and nurses to staff public geriatric hospitals, let alone private facilities, according to the CEO of an elder care company in the YRD. The CEO said the company had to develop its own training rubric for geriatric care because most Chinese tertiary institutions lack training programs.

## Land

Like other commercial real estate projects, land acquisition is very complicated. In China, patronage often trumps "rule of law", and the land auction system can be corrupt, according to industry veterans. Foreign healthcare companies and investors in both the private hospital and elder care submarkets often rely heavily on local partners or property developers.

Obtaining land can be challenging due to cost and zoning regulations. Searching for a plot of land for two or three years is not uncommon, according to recent entrants to the YRD. Those looking to build a new hospital in Shanghai will find that building permits are only available in the city's Minhang, Changning, and

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Hongqiao suburban districts, according to the president of a recently opened foreign owned medical center. Obtaining greenfield sites in the largest YRD cities for any purpose is lengthy and expensive, if not unattainable, added the president. This, however, is true in all of China's first-tier cities.

Joint ventures are often necessary in situations when a foreign entity needs land but cannot purchase the desired parcel. Working with a real estate developer is not ideal but can be more cost effective, according to the CEO of an elder care company. The CEO admitted that opening their first facility in China taught them that repurposed sites are too expensive. After spending millions of dollars to repurpose an existing building that took them three years to find they are working with a real-estate developer for their next project.

## Conclusion

China's burgeoning private healthcare space offers many opportunities to American healthcare operators and investors. Private hospital and elder care companies are benefiting from the country's ongoing reforms, rapidly aging society, and increasing disposable incomes in the YRD. The demand for better-quality medical care is strengthening as the emerging middle-class adopts Western diet and sedentary life styles, causing the incidence of chronic diseases like diabetes to increase. Described as a once in a lifetime opportunity by healthcare professionals in the YRD, China's private hospital and elder care submarkets offer alluring prospects to American investors and operators looking to export their products and operational know-how.

Although China offers many opportunities significant legal and operational challenges exist. To succeed, private medical institutions should not solely focus on general medicine but also specialize in fields that are growing in demand like cardiology, oncology, pediatrics, and geriatrics. Companies will find long-term success by refining their business practices to offer cost-effective health solutions for China's growing middle-class and their aging parents. Operators and investors looking to make quick profits will be frustrated by China's evolving private hospital and elder care submarkets.

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