



Full Transcript of China Health Care Part 2 Podcast August 30, 2009

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In our last Podcast, we started what I called an “occasional series” on China healthcare. I called it an “occasional series” because I am, at heart, a lazy son of a gun and don’t want to commit myself to any firm dates or responsibilities. Pretty smart, eh? And I suppose it is appropriate that we continue our China healthcare topic since I have caught a NASTY cold this week which should make recording this interesting, to say the least. Please bear with me...

Anyway ... last week we looked at the overall demographics of China and pondered just why healthcare is going to be such an important issue here in the next 5-10 years. We saw a couple of things happening ... first of all, as China has modernized, the old social welfare system of guaranteed education, housing and healthcare has gone away. Education and housing have, for the most part, improved and most everyone can get access. However, healthcare has not kept pace with a growing China and there are gaping holes in both the quality and availability of healthcare for many of China’s citizens.

Secondly, China is definitely getting richer, meaning individual wealth is rising. And as wealth (and its associated ability to spend) rises, so does a WILLINGNESS to spend and an expectation of better quality. This applies to healthcare where the growing Chinese middle class is starting to expect better healthcare and, in many cases, is willing to pay for it.

Thirdly, the traditional cultural norms of caring for ones family are still in place and children will feel an immense amount of pressure to care for their aging parents. With the one-child policy coming on in full force in the early 70s, we are starting to hit the first generation of one-child families who have to care for multiple aging parents – and expand that to two only-children marrying and needing to

support not only their own child but their parents and even grandparents, and you see the pressure some of these people are under. The high savings rate in China – upwards of 40% of total income – is attributed, in part, to people’s concerns about future spending needs on healthcare. Many economists feel that, if China were to fix their healthcare system, it would greatly increase consumer spending ... I am not sure I totally buy that, but it does have some inner logic.

Fourthly, as China has modernized and grown richer, the population has fallen prey to the so-called modern diseases found in many developed countries: hypertension, obesity, cancer and the like. It is a VERY scary thing to see a rapidly aging population heading into a crisis in which the existing healthcare system cannot support it.

Well, I keep talking about this quote-unquote “Chinese healthcare system” but I have not really outlined its features and functions (or DIS-functions, as the case may be). Today we are going to try to peel back the onion that is the Chinese healthcare system and describe the various layers. Then we can understand a bit better the challenges that the average Chinese citizen faces in taking care of their (and their families’) health and get a glimpse into the business opportunities available to foreign companies interested in playing in this growing market.

A caveat to begin, however ... as with healthcare systems around the world, China’s is incredibly complex and, even for many so-called experts in the field, not well-understood. My goal here is not to describe the minute details of the systems’ inner-workings; rather, I want to talk about the structures that have been set up and the various players involved. Those of you who have experience in this area, please weigh in on our blog ... the more voices we can get in on this, the better!

OK ... let’s start very practically ... where does the average Chinese citizen go to get their healthcare? In the U.S. (the system with which I am most familiar) there are lots of options for those with insurance: a doctor’s office, a healthcare clinic, a hospital, etc. In the U.S., typically, one decides where one goes based on the severity of the problem ... if you have a sore throat, you’ll go to the doctor or to a “Minute Clinic” of some type ... if you need surgery, you’ll see a doctor then go to a hospital.

In China, however, most healthcare services are centered at the hospital and for pretty much ANY ailment, that's where you will go. There are actually nearly 290,000 types of healthcare centers in China – hospitals, rural healthcare offices, outpatient and specialty clinics, etc. but the hospital is the focus of most of the activity in China's healthcare. We'll get into the reasons behind this (and some of the resulting challenges) in a minute but let's look more closely at their basic features.

First of all, 90% of all of China's hospitals are State-owned Enterprises (or SOEs) and are run like SOEs as well – they are big, bureaucratic and not known for their efficiency. We are starting to see some glimpses of private hospitals in China – or joint ventures between SOE hospitals and private investors – but these are quite few. It is odd, at least to me, that as China's modernization has been led, in part, by the government's willingness to open up many of its industrial and commercial sectors to foreign investment, they have been quite closed to foreign involvement directly in providing healthcare (although, as we will see, foreign equipment and pharmaceutical providers have always been welcome). Suffice it to say that Chinese hospitals are run as SOEs and, unfortunately, will also modernize like SOEs: slowly and with much pain!

Of the 290,000 some healthcare institutions in China, only about 20,000 of them are classified as “hospitals” and these are highly regulated. Chinese hospitals are segmented into two types: graded and un-graded. The graded are segmented into three “grades” with a couple of “classes” within each grade while the un-graded are just lumped into one category.

We can get into mind-numbing detail about the differences between the various grades of hospitals ... but the purpose of this Podcast is to inform, not to induce sleep, so I will try to keep it simple. Grade Three hospitals are the best ones in China ... they have the best doctors, the best equipment, and are reputed to have the best care. There are also relatively fewer of them in China ... only about 5% of hospitals in China are Grade Three, not quite 1,200 by the last count. The bigger cities such as Shanghai, Beijing and Guangzhou will have quite a few Grade 3 hospitals while the smaller cities in China will only have one or even none. The

average Grade 3 hospital in China has upwards of 500 beds (and some have many more) and can see anywhere between 3,000 and 5,000 patients per day (in-patient and out-patient). These are VERY busy places (and we'll see why in a minute). Grade 3 hospitals offer a complete range of services and cover most specialty areas and the highest classes in Grade 3 will also teach and do research. Grade 3 hospitals are regulated by the Ministry of Health (or MOH) at a national level and have to pass strict guidelines to maintain their Grade 3 status.

About 30% - or 6,500 - of the hospitals in China are Grade 2. These are located all over China and many of the Grade 2s can be specialty hospitals - maternity, cancer, heart, children's, etc. The typical Grade 2 hospital has between 200 and 300 beds and can cover most areas (including surgery). As I said before, there are very few private hospitals in China ... however, those that are going private tend to be the Grade 2 hospitals as they are of good-enough quality and tend to be regulated by provincial or even local MOH authorities that are easier to build good relationships with.

Grade 1 and ungraded hospitals are located in large and small cities of any tier all across China. These hospitals are of the lowest grade, with few beds (50 at most), and offer limited services. The vast majority of them cannot afford high-end medical equipment and their doctors are often not very well trained. Most Grade 1s and ungraded are run as subsidiaries of state-owned enterprises or even by associated medical device distributors. In recent years, the government has encouraged the development of community hospitals with sufficient resources to attract more patients with minor ailments. Typically, you will not find surgery theaters in Grade 1 and ungraded hospitals.

Now, the challenge in Chinese healthcare is that the average Chinese citizen only really trusts the healthcare offered in the highest grades of hospitals and when they get sick - no matter how sick they might be - they will go to as good a grade of hospital as they can afford. This means that, though the Grade 3 hospitals are only 5% of the total hospitals in China, they handled over 30% of the traffic last year. Talk about a HUGE bottleneck! And for the average hospital in China, there is no making an appointment ... you show up, get your name on a list and wait to see the

doctor. Kind of like taking a number at a New York Deli! But that means that you can wait an entire day or more before you are able to see a doctor.

And in the Grade 3 hospitals, you might wait several days for a bed to come open. Imagine this ... you are from several hours outside of Shanghai and you get a hernia or something – not life threatening, but certainly not something you want to wait to have attended to. So you make the long trip into Shanghai to see a doctor at a Grade 3 hospital and you wait ALL day to see her. She examines you, says “Yep, you got a hernia alright” and are told that you will have to have surgery to correct it. However, there are no beds open at the moment. You can’t go home but you can’t stay at the hospital either. So you hobble over to one of the many small hotels or “dormitories” surrounding the average hospital and check into a room there. You spend your days waiting at the hospital for a bed to open and your nights back at the dorm until one does. And remember, this is at the Grade 3 hospitals!

Ever conscious of opportunities to earn new revenues, many upper grade hospitals are now offering a so-called “VIP service” where you can pay an additional amount (sometimes many thousands of RMB) to be put on a fast-track to care. For those that have the money, they will often spend it ... but there are hundreds of millions of people in China who cannot afford this and they are stuck waiting.

So this is the big structural challenge for China’s healthcare system today ... how to “spread out” the traffic among all of the institutions available for care and to build a triage system, of sorts, so that people have an idea of where they should go for treatment based on the severity of their condition. But to do this, there must be a HUGE upgrade in the training, staffing and equipping of these lower-grade institutions because now, the average citizen simply does not trust the care that they would receive there.

And for good reason ... the minimum requirement for doctor education at upper grade hospitals in China is an M.A. in a medical field ... that’s 4 years of undergraduate and 2-3 years additional training. In the lower Grade hospitals and the many clinics around China, no medical training is required. A 2001 study of 46 counties and 780 village doctors in 9 Western provinces found that 70% of village doctors had no more than a high school education and had received an average of

only 20 months of medical training. I was talking with a neurosurgeon at a Grade 3 hospital once and I asked him where he got his training. “Oh,” he said, “I was actually trained as a dentist. But I observed a couple of brain surgeries and now I am a neurosurgeon!” Yep, that can be China ... where brain surgery isn’t even brain surgery!!!

There is also a challenge with finding comprehensive care in most hospitals in China. Most doctors are trained in a specific field and do not necessarily receive broad medical training as part of their overall education (if they have a medical education at all). So if you go in to the hospital for your hernia operation and you develop a problem with your heart, there is not a case manager or a general practitioner that will coordinate your care, finding you the right heart specialist to handle your issues. Sometimes your hernia doctor will know a heart specialist in the hospital and can convince him to come see you, but this is not always the case.

For China to really straighten out their healthcare system, they are going to have to invest MASSIVE amounts of time and money into upgrading the mid and lower level institutions in China. The trust level is going to have to be increased for these places to be able to attract patients ... and only then will the stress be relieved on the upper Grade hospitals and they can focus on what they do best: treating the most serious cases and doing research and teaching.

And China is doing this by pumping \$125 billion dollars into their domestic healthcare system over the next three years, much of it going to the mid and lower Grade hospitals. They know that they need to shore up the foundations of the system before they can build on top.

So for the average foreign investor, what does China’s healthcare structure mean for us. Well, I can see two areas:

First of all, for those involved in medical devices and pharmaceuticals, your clear target market should be Grade 2 hospitals and below because this is where the government investment is going to be and they will have the money to spend. You will need to pay close attention to the level of quality that is being demanded in these segments. We are doing a program now for a client who is looking to acquire a Chinese manufacturer of medical equipment for these middle Grade markets ...

and it took some time to identify just what features, functions and price points these Grade 2 hospitals were willing and able to spend. Once we determined this, then we went to look for Chinese companies already participating in these markets in whom our client could invest to upgrade their technology, improve their manufacturing processes and expand their sales networks.

But the entire time, our strategic focus has been on the needs of the Grade 2 hospitals. Its very tempting to get caught up in the sexiness of a new product or technology but if you are not going to find buyers for it, who cares??? Foreign companies will find it challenging to compete in this segment because there are already some very good Chinese suppliers ... but if they can find the right niche to play in, it could be a VERY lucrative market.

Secondly, we see opportunities for foreign companies and individuals to invest in Chinese healthcare providers ... hospitals and clinics in China that are looking for investment or to be taken private. This is a VERY new area and although there has been some marquee investment here in the past couple of years, we are just now starting to see the floodgates open. We are working with several Chinese healthcare sites – one private clinic and a hospital that wants to go private – and are working with them to get foreign investment: not only money but also know-how, expertise in running healthcare institutions for profit. We think that this is an area that will only get bigger.

So that about does it for today ... we've talked a bit about the structure of the Chinese healthcare system and how it is "upside down" of sorts, where the fewest institutions (Grade 3 hospitals) are attracting the greatest number of patients, thus diluting healthcare service offerings, at best and completely overloading the system, at its worst. To reform this structure, China is investing massive amounts in their mid and lower tier institutions. Its going to be awhile before we see the outcome of this, but at least it is starting.

Next time we will look at the ever-exciting issue of insurance in China. If you think there are complaints in the U.S., just think of here where nearly half of all a person's expenses for healthcare in China come directly from their pockets ... insurance provides for less than 10% of the total expenses. Yikes!

Thanks again for listening. Remember our motto: “In China, everything is possible but nothing is easy.” We’ll see you next time on the China Business Podcast.