

Favorable Policies Bring in VC/PE Investment Boom in Private Hospitals

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Favorable Policies Bring in VC/PE Investment Boom in Private Hospitals

Written By Cindy Zhang, Zero2IPO Capital

On December 3, 2010, the General Office of the State Council forwarded the Notice on the Opinions of Further Encouraging and Guiding Social Capital to Establish Medical Institutions (the Document No.58) issued by the National Development and Reform Commission and Ministry of Health, stimulating and channeling social capital into the establishment of medical institutions, upgrading the efficiency and quality of medical service, improving medical service system, phasing out policies harmful to the development of non-public medical institutions, ensuring qualified non-public medical institutions to be incorporated into the list of medical insurance designated institu-

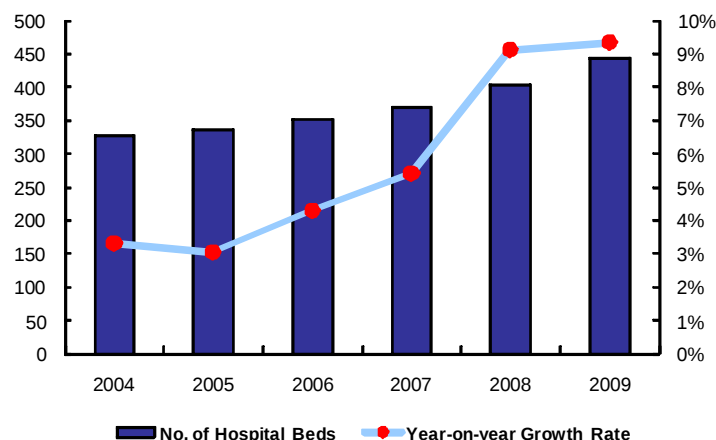
tions and compatible to the unified reimbursement policies with public medical institution, and identifying the unchangeable professional titles for the doctors job-hopping from public hospitals to private ones, with a bid to promote the sustainable and sound development of non-public medical institutions.

1. Encouraging and guiding social capital investment in medical institutions is of great significance.

According to the data released by Zero2IPO

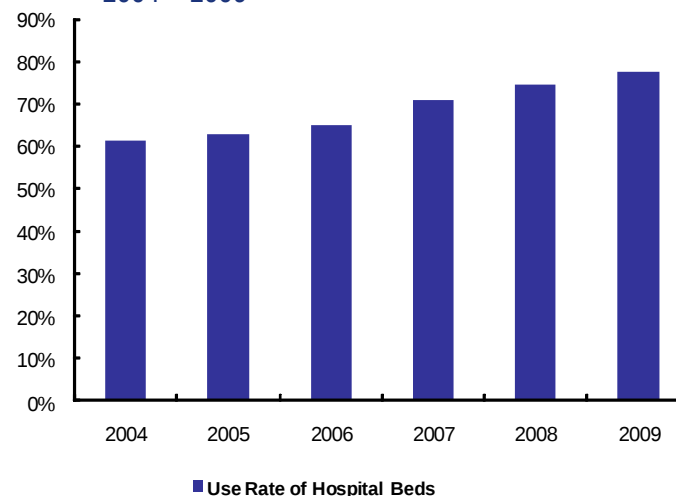
Database, although the number of medical institutions was on a par with the past years or even underwent drops sometimes, their scales have been expanding. For example, hospital beds totaled up to 4.42M in China in 2009, up 9.34% year-on-year, the compound growth rate of hospital beds registered at 5.71% between 2003 and 2009, among which the year of 2008 and 2009 enjoyed the rapidest growth, namely both above 9%. Despite the increases in the hospital beds, the use rate has been on the rise year by year, to 77.7% in 2009, up 3.1% year-on-year. The number of outpatient amounted to 3.5B in 2009, an increase of 11.1% year-on-year. According to the

Figure 1 Year - on - year Comparison of Number of Hospital Beds between 2004 - 2009 (Unit : 10 , 000)



Source: Zero2IPO Research Center

Figure 2 Year - on - year Comparison of Use Rate of Hospital Beds in Medical Institutions between 2004 - 2009



Source: Zero2IPO Research Center

above-mentioned data, the growth rate of public medical requirements has surpassed that of medical resource, in other words, medical institutions have been over-stretched.

The part and parcel of the enhanced medical system reform include the encouragement and guidance of social capital investment in medical institutions and establish-

ment of medical institution establishment system featured by diversified investors and investment types, conducive to enrich medical resource, spur service support, cater for the multi-tier and multi-outlet medical service requirements of the people, foster a competitive medical system, upgrade medical service and improve medical service system.

2. Encouraging equal treatment brings new opportunities for private hospitals

In February 2000, the Ministry of Health collectively staged out the Guiding Opinion on Town Medical Hygiene Structural Reform with other 7 ministries, to divided medical institutions into two types for the first time, namely non-profit and profit-making ones, for the identification of the key role of profit-making medical institutions in the national medical system. Then, there were a series of policies released to ensure equal competition, professional evaluation and medical insurance designated institution status for profit-making medical institutions, as well as

Table 1 List of Policies Concerning Medical Institutions

Date	Policy	Remarks
Feb. 2000	Guiding Opinions on Town Medical Hygiene Structural Reform	To establish a new medical institution classified management system to divide the medical institutions into non-profit and profit-making ones that adopt different financial, taxation and pricing policy and accounting systems.
Jul. 2000	Opinions on the Implementation of Classified Management of Town Medical Institutions	To identify again the classification benchmark for non-profit and profit-making medical institutions and point out profit-making medical institutions shall independently define its service items according to the requirements of customers.
Sep. 2001	Opinions on Some Issues in Classified Management of Town Medical Institutions	To further identify the role of non-profit medical institutions and profit-making institutions in the satisfaction of multi-tier medical requirements, and ensure an equal treatment for non-profit medical institutions in such fields as institution and personnel professional standard, medical institution evaluation, personnel professional evaluation and promotion, medical insurance designated institution status, scientific and research project tender invitation, etc.
Feb. 2005	Opinions of State Council on Encouraging and Guiding the Development of Non-private Economic Economy	It is the first document issued by the central government with the theme on promoting the development of non-public economy since the establishment of the People's Republic of China. Due to the 36 articles included, it was called as "Non-public 36 Articles". The opinions stipulated that non-public capital are permitted to flow into social undertaking field, and shall be supported, guided and standardized for the investment in education, science and technology, health care, culture, sport fields.
Oct. 2006	Decision of Chinese Communist Party Central Committee on Some Major Issues Concerning the Establishment of Socialism and Harmonious Society	To support qualified persons to practice business in accordance with the laws and regulation to provide convenient medical service for the public.
Mar. 2007	Some Opinions of the State Council on the Acceleration of Development of Service Industry	To encourage social capital entering into medical service industry.
May-07	Planning Outline of the 11th Five-year Plan on Health Care Industry	To encourage and guide social force to actively take part in the establishment of private medical institutions, develop medical service industry via various channels, enlarge support for medical service, encourage an equal and orderly competition.
Oct. 2007	Report to the 17th National Congress of the CPC	To separate non-profit and profit-making medical institutions, encourage social force to be involved in the establishment of public health service system, medical service system, medical insurance system, medicine support system.
Mar. 2008	Implementation Opinions of the State Council on Some Policies of Accelerating the Development of Service Industry	To encourage social capital flowing into medical service industry.
Mar. 2009	Major Implementation Programs on Medical Care System Reform (2009-2011)	To ensure private hospitals enjoying an equal treatment with public ones in medical insurance designated institution status, science and technology project identity, professional evaluation, continuing education, service access, supervision and management, etc.
Apr. 2009	Opinions of the State Council on Further Implementing Medical Care System Reform	To establish a government-dominated multi-outlet medical care input mechanism, and to form a medical institution establishment system featured by multi-outlet investors and various investment types.

support and encourage social capital flowing into medical service industry.

The Document No.58 provided a more loose policy environment for non-public medical institutions in license release, government procurement, personnel recruitment, academic climate, professional evaluation, equipment layout, etc. In this context, the treatment of non-public and public medical institutions are expected to be gradually on an equal footing, shattering all previous records and accordingly bringing more opportunities for private hospitals. The Document No.58 includes the following items, in addition to the reiteration of equal treatment of public and non-public medical institutions.

(1) To point out "supporting social capital to establish profit-making medical institutions, and encouraging qualified persons to set up private clinics" for the first time.

(2) To encourage social capital being involved into the restructuring of public hospitals and to rationally identify the sphere of the restructuring according to regional health care planning. To guide social capital to take part in the restructuring of public hospitals including State-owned ones via diversified ways. To actively and systematically transfer the part of public hospitals into non-public ones for the decrease of public hospitals and their reasonable layout as well

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Feb, 2010	Guiding Opinions on Pilot Public Hospital Reform	To encourage, support and guide social capital to enter into medical service filed and to ensure private hospitals enjoying an equal treatment with public ones in medical insurance designated institution status, science and technology project identity, professional evaluation, continuing education, service access, supervision and management, etc. The government shall relegate the part of public health service and public service to private hospitals via service buying. The provincial health care administrative departments shall actively and gradually restructure the part of public hospitals into non-public ones. And commercial insurance institutions shall be involved in the restructuring of public hospitals.
Dec. 2010	Opinions on Further Encouraging and Guiding Social Capital to Establish Medical Institutions	To encourage social capital to set up non-profit medical institutions, firstly permit the establishment of profit-making medical institutions, encourage social capital being involved in the restructuring of public hospitals in accordance with the laws and regulations, and permit overseas capital invest to set up medical institutions. Since 2010, the tertiary hospitals established by social force have been incorporated into the list of major clinical disciplines receiving state revenue subsidy, further perfecting the academic climate for non-public medical institutions.

as the formation of a multi-outlet medical institution establishment mechanism. To preferentially select reputable non-public medical institutions to join in the restructuring of public hospitals.

(3) To permit overseas capital establishing medical institutions. To further open up to the outside via revising the item of "medical institutions set up by overseas capital" into "permitted foreign investment projects". To permit overseas medical institutions, enterprises and other organizations to set up joint ventures or cooperative venture medical institutions in China with domestic medical institutions, enterprises and other organizations and gradually remove the limits on the shareholding proportion of overseas capital. To allow qualified overseas capital to establish pilot wholly foreign-owned medical institutions in China. Overseas capital shall be entitled to set up both profit-making and non-profit medical institutions. To encourage overseas capital to establish medical institu-



tions in the central and west regions of China.

(4) To encourage the donation for the establishment of non-profit medical institutions by social capital, spur enterprises, public institutions, social groups and individuals to donate for non-profit medical institutions established by social capital. To implement related taxation preferential policies. To encourage Red Cross, charities, foundations to inject capital to the establishment of non-profit medical institutions, or form a long-term donation relationship with non-profit medical institutions set up by social capital.

3. Despite more favorable policies, VC/PE shall be cautious in hospital investment.

Under the clear guide of healthcare reform and other state policies during the two years, VC/PE showed unprecedented enthusiasm in medical care investment. In accordance with the statistics of Zero2IPO Research Center, as many venture capital firms have bought into private medical institutions, China is undergoing an investment boom in private hospitals nationwide. Five private medical institutions garnered a total of RMB500.00M from VC/PE just during the first 11 months of 2010, clearly outperforming previous years both in number of investments and investment scale.

The Document No.58 of the State Council prescribes

that "non-public medical institutions shall be supported to allocate with large-scale equipments; local authorities shall fully consider requirements and reserve rational space for the development of non-public medical institutions while establishing and adjusting their large medical equipment allocating plan; healthcare organs shall approve the large medical equipments required for non-public medical institutions within their business scopes when approving the establishment and diagnosis subjects, and no restriction shall be placed upon those compliant with allocating standards and qualifications". From our point of view, easing restriction on non-public medical institutions to allocate large equipment would make for their development into large-sized and high-end hospitals, enhancing the development of large-scale non-public medical groups, chain hospitals in particular.

In spite of favorable state policies attracting massive capitals, private hospitals are still featured by unique risks in operation, so venture capital shall be cautious to rush for the field.

(1) Medical control risk. Services or products of medical services industry are usually related to consumers' health or even life, therefore medical technology and internal management are of vital importance, and a fatal medical accident may be the last straw for a private hospital.

(2) Replication and expansion

risk. Despite replicable business mode, as medical license, hospital land, reverse of talents and other resources may be inaccessible even with adequate capital, fast expansion would lead to quick downfall, without sufficient preparation and sound management.

(3) Doctor resources risk. Doctor resource as the soul of a hospital would finally determine the development of the hospital. Although state policies have been encouraging private hospitals to enjoy the same treatment as public hospitals in R&D, professional evaluation, continuing education, etc, private hospitals are still in a weak position in talent introduction, training and other aspects in comparison with public hospitals. Therefore, private hospitals have yet to improve mechanism to introduce and retain talents.

(4) "National treatment" problem. Though state policies have long since released private hospitals' application for medical insurance designated institutions, only "those non-public medical institutions carrying out medical services and medicine pricing policy prescribed by the government as well as complying with relevant regulations on designated medical institutions can apply", as per the Document No.58 of the State

Investee	Investor	Date	Investment Amt	Series
Angel Obstetrics & Gynecology	CDH Investment, Zero2IPO Capital	Sep. 2010	RMB100.00M	A
Yafei Dental	CEL Partners	Aug. 2010	N/A	A
Bosheng Medical	CCB International Wealth Management	Aug. 2010	RMB240.00M	A
Arrail Dental	KPCB, Qiming Venture Partners	May. 2010	US\$20.00M	N/A
Phoenix Healthcare	Tiantu Capital	Apr. 2010	N/A	B

Council. Such a provision of "carrying out medical services and medicine pricing policy prescribed by the government" has actually excluded profit-making medical institutions. Moreover, further considerations are necessary for venture capitals in selecting hospitals and exit options.

Therefore, it is worthwhile for venture capitals to focus on private hospitals with first-class experts and managers, modern management capability, flexible and efficient operation.

(1) Sound risk management system. Implement scientific and standard professional management, definitely divide the hospital management from diagnosis business to realize the unity between rights and liabilities and avoid repetitive management without overlap or vacancy, further improve diagnosis capability of doctor team, reduce occurrence of medical accidents, and establish strict medical and service management regulations pursuant to those recognized hospital management standards, i.e. international accreditation standard of JCI (Joint commission international) and national hospital accreditation standard.

(2) Rational talent structure and stable doctor team. Stable talent team could ensure and

contributing medical and management teams, but also persistently offer continuing education opportunities including medical staff training, academic exchange, advanced training, perfect performance evaluation system, motivate initiative, train and establish a reliable and hi-efficiency team.

(3) Expansible medical institution with standardized procedure. Medical service industry belongs to the high technology industry featured by risks and difficulties, and its service objects define greater market responsibilities and operation risks. Therefore, venture capitals favor those medical projects with simple business mode and standardized procedures.

(4) High-end hospital with definite orientation and quality services. Due to disadvantages in applying for accreditation of designated medical institutions, high-end hospitals which are positioned to massive patient base and avoid competition with medical insurance subjects can attract high-end consumers by relying on hi-quality services and professional medical technologies.

In conclusion, as China is witnessing constantly improved consumption level, increased urbanization and aging population, private medical in-



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