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## **Volume 16 - Issue 3, 2016 - Special Supplement**

### **A Closer Look At Financial Performance in Healthcare**

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## **MANAGING COSTS, RISK, AND FINANCING TO CREATE AN ECONOMICALLY SUSTAINABLE BUSINESS**

Healthcare providers around the world face resource shortages, economic and regulatory uncertainty, and increasing market volatility. Trends such as alternative compensation models and public-private partnerships are leading people to rethink established business models and adapt their investment strategies.

### **Investing during Difficult Times**

The bulk of medical costs is incurred during treatment. Fast and accurate diagnoses as well as effective therapy management and control can significantly reduce costs. The use of modern diagnostic technologies in imaging and the laboratory can help achieve this goal.

At first glance, the required investment may appear to be a financial hurdle. But investing in medical technology and in systematic and continuous training for staff can contribute to the proper management of diagnosis and treatment. This could help hospital operators minimize costly mistakes and opportunity costs, and thus substantially improve their cost structure in the long term.

### **A Growth Market under Cost Pressure**

Global healthcare expenditures amounted to approximately US\$7.2 trillion in 2013, which equates to 10.6 percent of global gross domestic product (GDP). Global expenditures continue to rise, but there are differences between regions.

The growing and aging world population, rise in chronic diseases, growing middle class in emerging markets, and advances in diagnosis and therapy are all key drivers of rising global healthcare expenditures.

However, for hospital operators, rising healthcare expenditures do not automatically translate to an increase in revenues and profits. Rather, faced with more patients, they come under pressure to reduce the cost of treatment as health systems increasingly respond to higher overall expenses with cost-capping measures. In the U.S., for example, financial challenges are still the biggest headache for hospital managers.<sup>1</sup>

Today, hospital operators take on risks formerly managed by insurance companies. This reversal of the value-added mechanism, away from a “fee-for-service” model and toward a “fee-for-outcome” model, changes the significance of investments in medical technology.

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In Europe and in the U.S., cost pressure and commercial risks abound. Nearly half of all European hospitals face financial difficulties, especially in countries such as Greece and Portugal. The high risk of bankruptcy within the industry makes it harder for hospital operators to access the capital market. According to a study by consultancy firm Accenture, the average EBITDA margin of selected European hospitals amounted to approximately 5 percent in 2014.<sup>2</sup>

Given increasing patient numbers and costs in both Europe and the U.S., greater efficiency is rising an existential concern for hospital operators. Meanwhile, financially sound healthcare companies can consolidate their market position through strategic investments.

### **Cost Efficiency in Asia**

In the search for innovative business approaches, it is worth taking a look at the Far East. In countries like China and India, low per-capita income, a rapidly growing population, uncertain economic prospects, and a shortage of beds and doctors in rural regions make efficient and affordable healthcare provision a special challenge. In India, the out-of-pocket spending rate is the highest in the world (approximately 70%). At the same time, India is one of the poorest nations in the world.

Narayana Health (NH), one of the world’s least expensive and very rapidly expanding hospital companies, was established in this environment. Since its founding in 2001, NH has grown from a small cardiology clinic into an internationally renowned, medical company with approximately 6,500 beds in 30 hospitals. Its success is mainly based on a low cost strategy. This involves efficient use of modern technology and optimized surgery capacity. In 2014, the Boston Consulting Group named NH as one of the 50 most successful companies in the emerging markets.<sup>3</sup>

### **The Medical Tourism Trend**

Many of NH’s patients come from abroad, which means NH is participating in the worldwide medical tourism trend. Many successful hospital operators secure lucrative patient flows from abroad thanks to excellent low-cost services, a good international reputation, and a focus on foreign target groups, especially wealthy private patients.

The huge market for medical tourism is fueled by a variety of motives: many who travel for care do so because treatment is much cheaper in other countries. For instance, the cost of heart surgery at NH averages less than €1,700; in the U.K., it is 7 to 10 times higher.<sup>4</sup> By the same token, wealthy patients from places like the Middle East and Eastern Europe often seek better medical care abroad.

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Published on : Thu, 25 Aug 2016

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