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The Investment Dilemma

Facing Hospitals

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The current position in Germany The Hospital Financing Law, KHG, of 1972 provided that investment in German hospitals would be allocated from public moneys (Section 4, Paragraph 1 of the KHG). The legislation established the

principle of dual financing, under which capital funding is paid from the public purse while hospitals’ operating costs are covered by the health insurance providers.

The amount of funding provided by the federal states has declined sharply in recent years. In 1995, the overall financial contribution from this source amounted to 1 3.8 billion but by 2005, the figure had dropped to 1 2.7 billion, a reduction of 28%.

The sharp decline in financial support from the federal states has been shadowed by an increase in investment requirements. A number of factors have contributed to rising capital costs. They include the imposition of new conditions and legal requirements and pressure on hospitals to consolidate their position in the healthcare market. Economic studies have shown that the current shortfall in investment is between 1 30 billion and 1 50 billion (Source: The German Hospital Institute – DKI). Even assuming the maintenance of the status quo, i.e. the number of hospitals and volume of

infrastructure will remain the same, substantial investment requirements are still anticipated. However, it must be borne in mind that the number of hospitals is set to significantly decline as competition in the market intensifies. This trend will impact first on hospitals with high investment needs arising from infrastructural deficits.

The Alternatives for Hospitals

When public funding is no longer sufficient to fund necessary investment, hospitals must find alternative means to cover costs. Two options are open to them; they can either fund investment programmes:

• from current operations or

• transfer the costs to new partners.

Focused investment frequently delivers improvements in operational processes and procedures, which in turn delivers better financial results for the organisation. It therefore allows hospitals to exploit the positive impact on their bottom line to extend the options available to them.

Involving partners in certain areas of the hospital’s operations can shift investment costs to the partner because it undertakes investment projects, thus delivering improvements in processes and reducing costs. This form of cooperation creates a win-win situation for everyone involved. Evidence gathered in a number of strategy projects

in hospitals shows that private partners can be integrated into all aspects of the business system.

Public/Private Partnership models (PPPs), long-term, contract-based cooperation arrangements between public or private hospitals and private companies, are an attractive option.

Every aspect of a hospital’s business system can and should be examined to identify potential areas of co-operation with industry partners. For example, in the medical supplies division, PPP models could make economic sense in the area of medical technology (for instance, in delivering

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complex diagnostics and therapies). In the medical services division, hospitals could consider introducing a PPP for laboratory services. In infrastructure, it is conceivable that a hospital might enter into a PPP arrangement with construction companies or service providers operating in the field of

infrastructural facility management. Hospital administration also offers the potential to engage private partners in PPPs. From the perspective of the hospital, it is a matter of identifying the most suitable partner for the relevant task and then establishing a contractual relationship with the company in question.

The first step is to identify the model to be used (the type of co-operation arrangement and the area in which it will operate). The right partner must then be found. The hospital short lists potential partners it believes to be best suited to achieving a set of defined goals. The final and most important step is to carry out an economic appraisal of the project, which entails comparing two variants – one with the participation of a private partner and one without external participation (see Figure 4).

Depending on the form and content of the selected project, it is possible to differentiate between financing models, management models and operator models. A systematic evaluation, using a specific project, should be carried out to determine the most appropriate model for addressing the problems of the individual hospital.

Summary: Exploiting the Potential of PPP Models

In our view, involving partners in the business system of a hospital creates opportunities to significantly reduce investment requirements. Every hospital should critically examine its value chain and identify the points at which

positive effects might be expected from collaboration with private partners using a Public/Private Partnership or Private/ Private Partnership model. These effects should be quantified in advance to ensure the expectations of partners can be pinpointed during discussions on co-operation. False and unrealistic expectations are one of the greatest obstacles hindering the implementation of sensible co-operation plans.

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