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Start To Think About Entering China's Health Care Market

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After the news this past July that German hospital operator Artemed had signed a framework agreement to establish the first wholly foreign-owned hospital in the Shanghai Pilot Free Trade Zone, foreign investors anxious for an opening into China's tightly regulated health care sector may have further reason for optimism.

The Chinese government has announced the launch of a pilot scheme allowing for the establishment of wholly foreign-owned hospitals ("WFOHs") through greenfield investment or mergers and acquisitions in three centrally governed municipalities (Beijing, Tianjin and Shanghai), which have provincial status, and four provinces (Jiangsu, Fujian, Guangdong and Hainan).

The Aug. 27 announcement was made through a joint administrative notice between two key central government agencies, the National Health and Family Planning Commission ("NHFPC") and the Ministry of Commerce ("MOFCOM"), and is yet another example that the Xi administration is sincere in its rhetoric about using the Shanghai FTZ as a test lab for potentially nationwide economic reforms. It also comes at a time when the government is trying to keep up with a rapidly aging populace as well as ease growing tensions nationwide between doctors and patients evidenced by a series of knife attacks by patients against their doctors.

The provincial branches of the NHFPC and MOFCOM will be responsible for approving WFOHs. Investors are expected to have strong track records in the operation and management of medical institutions and be capable of bringing in advanced medical technology and hospital management expertise from abroad. Only investors from Hong Kong, Macau and Taiwan may open WFOHs focused on traditional Chinese medicine.

While the notice certainly represents a step forward, current challenges may remain with respect to the hiring of foreign medical practitioners, import of drugs and medical equipment, exclusion from the Chinese national medical insurance system, and lack of nonprofit status because the notice does not specifically touch upon these matters. A press conference in late September indicated that NHFPC and MOFCOM are formulating a further administrative regulation on foreign investment in medical institutions, and in doing so are reportedly considering ways to address all but the last of these challenges.

Health care, a sector closely linked to the state, has been slower to open up to foreign investment than

many other sectors of the Chinese economy. Starting in July 2000, foreign investors were permitted to invest in mainland Chinese hospitals through "equity joint ventures" or "cooperative joint ventures," and hold up to 70 percent of the equity in these entities. Since then, certain openings were created for investors from Hong Kong and Macau (and later Taiwan) to exert full ownership over hospitals in certain geographic areas, but the results were modest and most foreign investors interested in full ownership remained out of luck.

The first sign of an opening for all foreign investors came in the form of a November 2010 notice issued by the State Council announcing that restrictions on foreign investment in medical institutions would gradually be relaxed and that a pilot program for allowing such foreign investment would be set up. While the health care sector was removed from the restricted list in China's Foreign Investment Catalogue in 2011, it wasn't until late 2013 into 2014 that further signs appeared that the State Council's notice would be implemented. The Shanghai FTZ's framework plan (issued in September 2013) stated that full foreign ownership of hospitals would be permitted within the zone, and Artemed appears to be the first to test those waters. Now, the pace of reform appears to be accelerating.

Interested foreign investors must now wait for more detailed implementing proposals to be put forth by the provincial branches of the NHFPC and MOFCOM (according to one report before the end of the year), and reviewed by the NHFPC and MOFCOM at the central level, before they can establish WFOHs. In the meantime, though, foreign investors can start to do some advance work.

Specifically, foreign investors can identify geographic areas of interest and build relationships with local officials. As Chinese officials become more sophisticated, they are increasingly open to collaboration with outside participants who serve as trusted advisors and partners in development. These relationships can be crucial to the success or failure of any business operation in China.

Strong relationships with local officials and regulators may also benefit foreign investors by facilitating introductions to key local business interests and organizations relevant to possible future operations. Among other targets, potential investors may consider exploring connections with commercial insurance companies, to help lower costs in a very cost-sensitive health care market, and state-owned medical institutions, with whom they may share medical resources and patients (as Artemed does with the Shanghai Waigaoqiao Medical Centre in the Shanghai FTZ).

While experiences may vary, foreign investors interested in pursuing opportunities under the new pilot scheme may also seek to learn what happened to foreign investors who entered the Chinese market through joint ventures (e.g., CHC Healthcare). They should also consult with Taiwan and Hong Kong-based investors who entered the Chinese market through WFOHs (i.e., Shanghai Land Seed Hospital and C-MER Dennis Lam Eye Hospital). Their experiences may illuminate potential risks that either have to be mitigated by investors or reduced by policymakers for a successful entry into the market.

In the final analysis, the government appears to be permitting foreign-owned hospitals because they will satisfy China's needs. Foreign investors can take advantage of this opening, but in doing so, should carefully monitor the situation and proceed with care.

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