Private healthcare is ripe for transformation

It's no secret that a small number of 'big names' dominate the private healthcare and medical aid industries. In addition to lack of competitiveness, another issue is also the lack of transformation in the healthcare industry, with most hospital management entities still white-owned.

Mashudu Mphafudi, director in the finance & banking practice at Cliffe Dekker Hofmeyr

In light of the National Health Insurance (NHI) financing system, the Competition Commission’s investigation into the private healthcare sector, and other healthcare-related considerations and concerns, it’s vital that stakeholders in the medical industry not only rely on their legal and financial partners, but also use them to transform a controversial sector.

“The recent Competition Commission’s market inquiry into the country’s private healthcare sector found that although there are 22 open medical schemes, there are two medical schemes that constitute approximately 70% of total open scheme market (as measured by number of beneficiaries). These are the Discovery Health Medical Scheme (DHMS) and the Government Employees Medical Scheme (Gems)," says Mashudu Mphafudi, director in the finance and banking practice at Cliffe Dekker Hofmeyr.

Similarly, only three private hospital groups - Mediclinic, Netcare and Life - have a combined market share of approximately 90% of the national South African private facilities market in terms of total number of admissions.

What the dominance of these groups means is that private scheme funders must contract with at least one of the three big facility groups, and they cannot afford to exclude one of these groups from any provider networks. “As a result, the current medical aid system lacks competition and clarity and consumers are simply not getting fair value for money. If, however, the market had larger providers, a funder would have the option not to contract with one or more of the groups, creating a new bargaining dynamic that would benefit the consumer,” he says.

No competition

Thus, there is a genuine need in South Africa for hospital project funding for private facilities to create a more competitive environment with alternatives to the ‘big three’. The gap in the medical market lies in black-owned, private hospital groups and medical aid insurance sector that will list on the Johannesburg Stock Exchange (JSE), as highlighted by the recent Competition Commission’s market inquiry. But this is easier said than done.

To start-up and maintain profitability, these private sector facilities need a good story to tell investors, demonstrate that they have the technical and operational capacity and experience to operate private hospitals, and, most importantly, the sponsors may be required to provide stand-by equity during the ‘ramp-up' period. These new groups will also need to seek out the right investor who has the appropriate level of risk appetite and recognises the transformative potential of alternative healthcare providers.

“However, even if the initial investment is secured, the first three years (particularly in the context of a greenfields project) in the healthcare space are some of the most difficult, as the facility needs time to attract both clients and healthcare professionals. This is where a financial partner needs to understand these challenges and offer the relevant support, such as providing a period with no loan payments while the facility comes into its own. Generally-speaking, the right lender will have funded a greenfields project before so that they understand both the risks and benefits of such an undertaking," he says

It is also important for sponsors of these infrastructure projects to get the right type of finance - project finance is typically used for greenfields projects rather than corporate finance.

- Project finance minimises risk to the project company as the lender relies only on the project revenue to repay the loan and cannot pursue the project company sponsors assets in case of default. However, the project company can only use project finance where it can demonstrate that revenues streams from the completed project will be sufficient to repay the loan.
- In a corporate finance structure, the company (building the project), typically procures funding by demonstrating to lenders that it has sufficient assets on its balance sheet to use as collateral in the event of default. The lender will be able to foreclose on the company's assets, sell them, and use the proceeds to recover the outstanding loan.

Along with having the appropriate lending partners, it’s vital for new institutions to link up with the right funders; people who will understand that although there is a need for healthcare alternatives, these cannot be established overnight. They will also recognise the ultimate value that a more competitive market will bring to the end-consumer.

Untold story

Over and above the various factors mentioned above, sponsors and their project companies also need to have an experienced legal team to enable them to identify any issues at an early stage of the proposed infrastructure project transaction. Above doing the usual due diligence, investors need legal counsel that has the expertise in the industry and understands the legal and political landscape. This way, investors will know beforehand of any potential stumbling blocks that could derail the investment.

“By and large, there’s still an untold story in the healthcare sector – the story of black-owned groups coming together, breaking the status quo, forming robust institutions, and taking them all the way from conceptualisation through to the path of listing. But this story need not be a fairy tale. South Africa’s healthcare sector has the potential to be disrupted and transformed – with the right minds and the right partners in place,” Mphafudi concludes.