Putting their money where the money is

The U.S. healthcare sector draws plenty of foreign direct investment. But not providers. Could universal coverage change that?

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Every year, foreign companies and investors pour billions of dollars into U.S. investments. In 2000, with the dot-com bubble still filled with air, foreign direct investment in the U.S. was $335.6 billion, according to the U.S. Commerce Department's Bureau of Economic Analysis. After the bubble burst, foreign direct investment plunged to a low of $54.5 billion in 2002, but it rebounded to $276.8 billion last year.

No other country in the world draws as much foreign direct investment as the U.S. The 2007 estimates of foreign direct investment by the U.N. Conference on Trade and Development place the U.S. more than 12% ahead of No. 2, the U.K. Investment opportunities in the U.S. are simply stronger than in many other economies, and the weakness of the U.S. dollar, until recently, further promoted foreign direct investment, says

C. Richard Torrisi, an associate professor of international business at the Sawyer Business School at Suffolk University, Boston. "The U.S. is the largest recipient of foreign investment in the world. That has not changed, no matter the state of the economy," Torrisi says.

And yet, healthcare service providers—a giant part of the American economy, with the hospital sector alone accounting for revenue of $648.2 billion in 2006, according to the CMS' national health expenditure accounts—have traditionally seen little in the way of foreign investment, experts say. The Canada Pension Plan Investment Board's backing of startup Legacy Hospital Partners, Plano, Texas, is the exception (Jan. 21, p. 6).

"Most foreign investors come from environments and societies where healthcare provision comes out of the public sector," Torrisi says. "They're familiar, essentially, with publicly provided free or low-cost healthcare services. In the U.S., they've got to adjust to this highly competitive industry driven by variable controls in the public sector, at both the federal and state levels for healthcare expenditures."

Foreign direct investment, in the U.S. and elsewhere, has tended to be greater in manufacturing than in services, Torrisi points out, and foreign investors have piled in to the manufacturing side of the broad U.S. healthcare market, such as pharmaceuticals and medical devices. When foreigners have invested in American service companies, they have done so in sectors such as insurance, transportation services and entertainment—particularly movie studios—where American companies have brand names and know-how that can be leveraged in the acquiring company's home market, Torrisi says.

Cultural factors also have played a role in the lack of foreign direct investment in healthcare services, experts say. Consumers would be expected to react more strongly and negatively to a foreign owner-operator of a hospital than of, say, a restaurant chain. Moreover, running a hospital requires deep local knowledge, from physician relationships to patient expectations, so perhaps it isn't the type of service that an operator can expand beyond its domestic market.

Return on investment in hospitals may not be high enough or certain enough to lure foreign investors. Also, bad debt is a problem that private healthcare providers in other countries don't face, as private provision of healthcare services outside of the U.S. has been geared toward services provided to wealthy patients who can afford them, says a healthcare investment banker. Healthcare reform could affect both of these factors, however.

“I think that will change,” Torrisi says. “There’s no question that given our demographics, given, probably, the growth of universal coverage in the U.S., I think foreign investors will see it as more stable and less risky.”

Cars vs. cardiac care

Manufacturing accounted for about half of the foreign direct investment in the U.S. in 2007, according to the Bureau of Economic Analysis (See chart, this page). Consumer and industrial goods are particularly ripe for foreign direct investment because the products and the manufacturing techniques can be applied to the acquirer’s home market and its other products, Torrisi says.

Hospital services have always been intensely local, providing less scope for a well-known brand that would attract a foreign buyer. The most famous branding campaign among hospital operators was by the former Columbia/HCA Healthcare Corp., Nashville. HCA ditched the national branding campaign in 1997, shortly after the company plunged into numerous federal and state healthcare fraud investigations (Aug. 11, 1997, p. 2).

That said, there are American healthcare brands that have gained world renown to show that it is possible, says James Brennan, a head coach with VirtualCDO, a consultancy that offers business development, strategic planning and corporate governance services to healthcare companies. Top executives from around the world visit locations operated by the Mayo Clinic, Rochester, Minn., for treatment and checkups, Brennan says. While such services can be expensive, they’re cost-efficient for large, global companies that have made a big investment in their top management talent, he says. The American healthcare system may be perceived by foreign companies as too costly and lacking fairness, but its quality is considered the best or among the best, he says.

While manufacturing, like healthcare services, faces tremendous competitive pressure, a lot of foreign direct investment is made by companies wanting to establish an American base for their sales here, Brennan says. These American beachheads enable foreign manufacturers to reduce worries about changes in the value of the U.S. dollar, transport costs and the political backlash from running a large trade surplus with the U.S., he adds. The most prominent example comes from the automobile industry, with German and Japanese manufacturers establishing plants in the South.

Cultural barriers

When out-of-state hospital systems announce a hospital acquisition, those companies are often met with critics who say that their community’s healthcare needs shouldn’t be dictated from a corporate headquarters hundreds or even thousands of miles away, so perhaps foreign companies would be even less welcome as hospital owners. The issue of foreign control came up in the recently scuttled sale of 223-bed Anaheim (Calif.) Memorial Medical Center to Pacific Health Corp., Tustin, Calif., since Pacific’s parent company is based in Germany (Aug. 18, p. 16).

“Think about it in your own hometown. Imagine if your local hospital was purchased by a French company, for example. Would that be well-received by the local community? I’m not really sure,” Brennan says. “If it’s just an investment, a financial purchase, that’s one thing, but if a foreign management team showed up and tried to impose their corporate culture and strategies, I doubt it would work.”

As with the lack of national brands, this cultural barrier is part of the intensely local and fragmented nature of healthcare services. “You still have to provide local care,” Brennan says. “It’s not like a software company where you can support the software from somewhere in Europe.”

Brennan also believes that relationships with medical professionals would be complicated by foreign ownership. For investor-owned hospital companies in Europe, India and Latin America (March 3, p. 28), relations with physicians are vastly different than those between hospitals and physicians in the U.S. Indian physicians tend to be independent practitioners who take direction from their local hospital as if they were employees, while physicians in Latin America are frequently paid for referrals.

Brennan does see a niche that foreign operators could exploit: urban ethnic communities. An Israeli company buying a hospital in New York or a Mexican company buying a hospital in an immigrant neighborhood in Houston or Los Angeles “might be perceived as a great thing,” he says.

Operating environment to improve?
The reimbursement system in the U.S. is a culture that American hospital operators are used to, but it, too, presents a barrier to foreign investment in healthcare services, says James Forbes, global head of healthcare investment banking for Merrill Lynch & Co.

“The whole issues of Medicare and Medicaid and a bad-debt problem are alien to foreign investors,” Forbes says. Foreign hospital operators have mainly been geared toward private-pay patients, so they haven’t experienced these issues in their domestic markets, he says, so they shy away from investing in U.S. healthcare providers.

Moreover, operating an American hospital is a difficult business with lower returns than the sectors that foreign investors prefer to sink their money into, Brennan, Forbes and Torrisi agree. “This is one of the hardest businesses around to be in,” says Brennan, a fellow of the American College of Healthcare Executives. “Running a hospital, you don’t make a ton of money in it. You’re lucky if you make 10% on the bottom line. If you can take the same investment and get 20%, you do it.”

Private-equity investors expect much better returns than healthcare services have traditionally yielded, but healthcare reform could swing that calculation more in healthcare’s favor, Torrisi says. “I think that over the next four years, through healthcare reform and health cost management, a lot of private providers in the States are going to look a lot better as investment opportunities,” he adds.

Foreign private-equity firms and sovereign wealth funds—investment funds owned by governments (See chart, p. 28)—also face competition for acquisitions from 10 to 20 American private-equity firms that are well-versed in healthcare services, Forbes says. Their investments in other healthcare sectors, such as pharmaceuticals and biotechnology, could be a way for foreign investors to learn more about American healthcare services, Forbes says.

Becoming more familiar with the American healthcare system would foster foreign direct investment in services, Forbes says, noting that some of the large foreign investment organizations are setting up offices in the U.S. Merrill Lynch’s healthcare investment banking group has met with some of these organizations to talk about the opportunities in healthcare services, Forbes says.

Other entry points to healthcare services for foreign investors are outpatient services and disease management, Brennan says. “They’re higher-return items with lower barriers to entry,” he says. “It’s hard to start a U.S. hospital from scratch. It’s a lot easier to start a surgery center or an outpatient clinic.”

What do you think?

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