Breaking up is hard to do

The competition watchdog wants private hospital groups to sell 20 hospitals. Will it get its way, asks **Daniel Thomas**

The UK's private healthcare map looks set to be redrawn, as the Competition Commission (CC) on 28 August recommended that the UK's largest hospital groups divest up to 20 hospitals.

After a wide-ranging investigation of the private healthcare sector, the CC found significant instances of anti-competitive behaviour in the market, and criticised major operators for generating "excessive" profits.

It also condemned consultant incentive schemes and the lack of comparable information on consultants and hospitals available, and promises remedies for both.

In its provisional findings, published 28 August, the watchdog said the three biggest groups – BMI, Spire and HCA – would be subject to divestiture if it went ahead with its proposed remedies. However, BMI, HCA and Spire say they dispute the watchdog's findings and hope to change its mind before it publishes its final report next April. Some hospitals may be preparing to take legal action, too.

"You can expect some major operators to initiate a judicial review and conduct strong legal challenges if nothing changes in these proposals by next April," says Mihir Magudia head of healthcare at Bellenden Public Affairs. "Given the current evidence base, it's not at all certain whether a review would support the Commission's findings."

Launched in April 2012, the CC's investigation promised to explore how the relationships between private hospitals, insurers and consultants could potentially hinder competition, raise barriers for new entrants and impact cost and quality for consumers.

A key line of investigation has concerned whether hospitals face insufficient competition in local areas, which in theory allows them to push up prices and manipulate price negotiations with private medical insurers at a national level through their "must have" hospitals (referred to as "one in, all in" agreements).

As anticipated, however, the watchdog has found hospitals do have too much local sway.

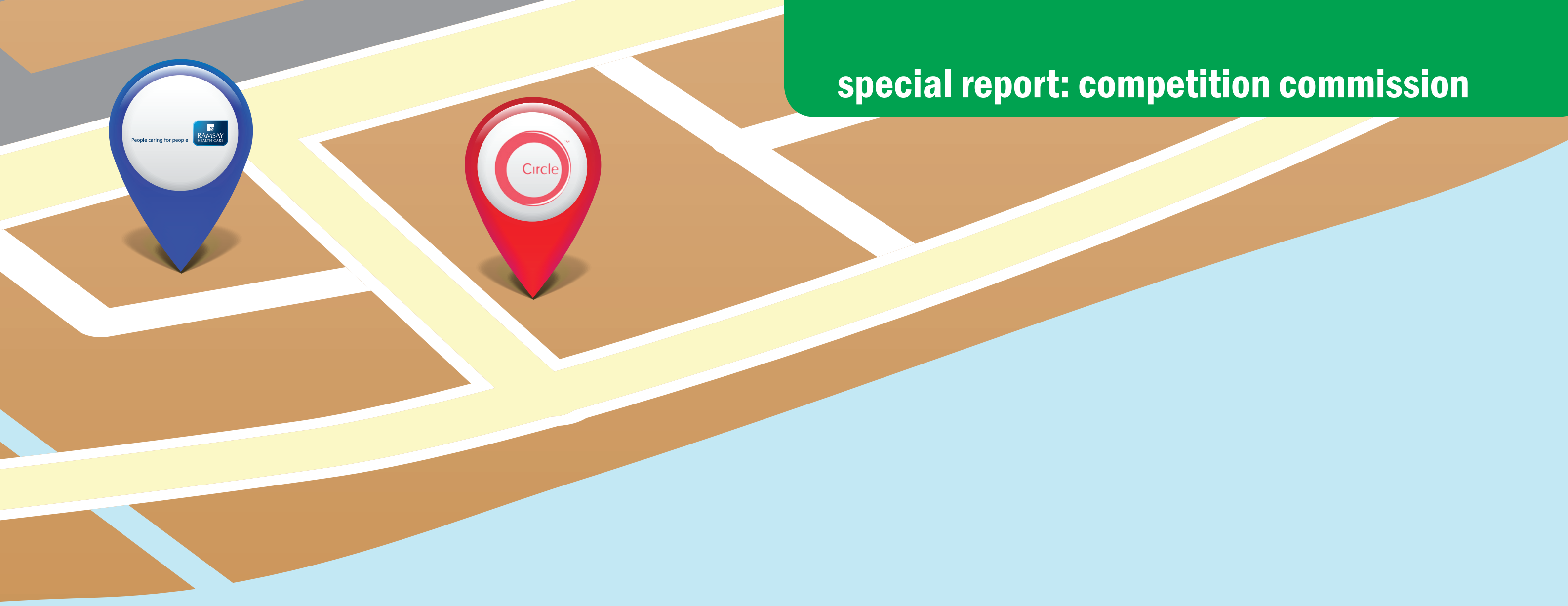
It claims that four of the top five earned "returns substantially and persistently in excess of the cost of capital" between 2009 and 2011, the period under review. BMA, Spire and HCA, for instance, are claimed to have cost the consumer between £173 million and £193 million a year collectively – some 10-11% of their private revenues.

It also believes they hold the upper hand when bargaining with insurers. Chairman of the Competition Commission, Roger Witcomb said: "Although Bupa and AXA PPP have some clout, we haven't found that this completely offsets the power of the hospital operators."

However, reflecting the mood of the biggest chains, BMI's chief executive, Stephen Collier said: "In terms of the relationship between hospital operators and medical insurers, BMI Healthcare plainly does not hold the whip hand... Networks are created and maintained by insurers, not hospital operators, and insurers use them to drive competition between hospitals for network status."

The watchdog's most drastic remedy would be to force BMI, HCA and Spire to divest one or more of their units in areas where there are clusters of hospitals run by operators. As such, HCA would lose units in London, a market it dominates with six private hospitals (and a number of PPUs); outside London, BMI and Spire would be forced to do the same in certain geographies.

Market sources believe Nuffield, Ramsay and Circle Health, the next three largest groups, may be in line to pick up the assets. New entrants would be welcome to bid too, although some argue divested hospitals might be a hard sell without economies of scale behind them. However, speaking to *HealthInvestor*, group commercial director of HCA,



Keith Biddlestone argued that divestiture to less experienced health providers would be a mistake, and that the CC will ultimately drop the idea.

"We have 29% of the beds in London and we think barriers to entry are low – people have come in an expanded. If you wanted to you could get in to London and compete with us... It's not in the consumers' interest to oblige us to sell these hospitals."

The CC has also promised to end "one in, all in" arrangements which force the PMI to accept higher prices or hospitals it doesn't want. The CC would either seek to prevent hospitals from raising their prices nationally in the event a medical insurer decided not to recognise a hospital; or require hospitals to price their hospitals separately and individually.

Further to this, it would prevent the expansion of operators who run single or duopolies in certain areas, restricting the opening of new units or initiating new partnerships with NHS PPUs.

Clamping down on incentives

In another blow to the hospitals, the CC has said it is "concerned that consultant incentives might tempt consultants to refer patients to a hospital that they would not have chosen on grounds of either quality or of price and that they might lead to over-treatment or unnecessary diagnostic tests".

As such it wants to stop hospitals offering incentives either in "cash or kind". This would rule out fee referral schemes, as well as offers of free use of facilities, for instance. Schemes where consultants hold equity shares in a clinic would also be banned, but, rather puzzlingly, only if they were proven to distort competition. Circle, which runs an equity share model, would seemingly not be affected by the rule, which raised an eyebrow among its competitors.

Less controversially the CC has called for more comparable information to be made available to patients about consultants and hospitals – a move welcomed by insurers and hospitals alike.

Firstly, it says NHS England's publishing of consultant performance indicators online should be extended to the health departments of Scotland, Wales and Northern Ireland.

Then, to tackle the growing problem of 'shortfall fees' – in which consultants levy unexpected charges exceeding a patient's policy cover – it proposes all consultants practicing in private healthcare should publish their fees online and notify patients in advance of the full costs of treatment.

The CC also found that "much more information is currently available to consumers on the quality of services provided by NHS hospitals than is available for private hospitals". It acknowledges the Private Hospital Information Network – a group supported by the main private hospital providers – has been working towards this since April 2013. However it says any outcome must result in private providers collecting an HES equivalent and PROMs data for patients to access, as happens in the NHS.

"We support the Competition Commission's recommendations on increasing transparency around clinical outcomes and pricing," said Spire's CEO Rob Roger, adding that Spire had published the prices of its top 75 self-pay procedures online earlier this year. "Anything which helps GPs and patients make informed decisions about their healthcare is to be welcomed."

The biggest PMIs, Bupa and Axa PPP, will not see any of their activities curbed by the watchdog – although it did urge Bupa to provide consumers with clearer information concerning its Open Referral policy (in which the insurer, not the GP, chooses consultants on the patient's behalf to minimise costs). Nor will consultants be stopped from forming groups – which some have alleged pushes up prices.

BMI, Spire and HCA have already robustly disputed the CC's findings and reiterated their provisional nature. They have argued throughout the investigation that the CC has used faulty methodology to assess their return on capital employed (ROCE) and market catchment areas through the LOCI methodology.

However, a spokesman for the Competition Commission told *HealthInvestor*: "LOCI has been used in conjunction with other type of catchment analysis and we have also looked in detail at the circumstances of hospitals where competition remains a concern, taking into consideration a wide range of factors.

"As for ROCE, we published a working paper on profitability and took into response comments received. We didn't agree with all arguments put to us and we think our approach has been fair and reasonable. Again this will be covered in detail in full report."

All parties have until 20 September 2013 to submit formal responses to the provisional findings. The Competition Commission will publish its final proposals in April 2014. ■

Circle

Steve Melton, chief executive, Circle
(see this month's interview with Steve on page 36)

Story: Co-founded in 2004 by former Goldman Sachs banker Ali Parsa and consultant ophthalmologist Massoud Fouladi, and handles both outsourced NHS services and independent care.
Owned by: Circle Holdings (publicly listed)
Size: Two independent hospitals in Bath and Reading; one clinic in Stratford-upon-Avon; one NHS treatment centre in Nottingham; one NHS hospital at Hinchingbrooke.
Turnover in FY 2012: £170.4 million
EBITDA in FY 2012: Loss of £14.2 million

Circle prompted the CC's investigation after complaining to the OFT about the treatment it received when trying to open its hospital in Bath. It argued the market power of BMI's hospital in the city had prevented it from securing early insurer recognition from AXA PPP (which affected its ability to secure debt finance), and that BMI lowered prices to block its exit. It says such problems prevail nationally.

It has welcomed the CC's findings, having argued for a more transparent insurer recognition regime; an end to consultant incentives; and for PH power over insurers to be nullified. While it has the ambition, it's unclear whether Circle has the firepower to buy the divested hospitals, but has raised significant sums of money in the past. CFO Paolo Pieri said: "This report is clear that patients across the country have suffered higher prices and poorer care because of the monopolistic behaviour of private hospital providers. We now look forward to the Competition Commission pushing through these remedies with haste – including pursuing the maximum financial penalties."

Spire Healthcare

Rob Roger, chief executive, Spire Healthcare

Story: Spire Healthcare was formed from the sale of Bupa Hospitals to Swiss private equity firm Cinven in 2007, and the subsequent purchase of Classic Hospitals and Thames Valley Hospital in 2008.
Owned by: Cinven
Size: Owns 38 hospitals; 11 clinics; the London Fertility Centre; Perform, a sports medicine, physiotherapy and rehabilitation brand; and screening service Lifescan.
Turnover in FY2012: £739 million
EBITDAR in FY2012: £204.4 million

Like other big PHs, Spire has been irked by the methodology employed by the CC during the investigation. Spire argues its ROCE has been overstated, and that 'solus hospitals' are the result of limited local market demand than of a lack of competition.

Similarly it argues that the CC underestimated the time for which patients are willing to drive to receive care, thus understating the degree of local competition in a number of cases. And it questions why the CC has exclusively focused on inpatient care, which accounts for less than half of Spire's private healthcare business. Like its rivals, Spire says PMIs have considerably more market power than the CC gives them credit for. It disagrees with PMI caps on consultant fees and the policy of open referral, and blames barriers to entry on the high fixed costs of operating private hospitals, arguing that lack of PMI recognition can impede entry, too.

CEO Rob Roger said: "We believe these findings, and the remedies proposed, are based on an unrealistic assessment of the markets in which we operate and the level of investment necessary to operate a high-quality hospital. These findings are also contrary to the evidence we presented to the Competition Commission."

BMI/GHG

Story: BMI Healthcare is the UK's largest private hospital group and the operating company of General Health Group (GHG). GHG was acquired in April 2006 by a consortium led by Netcare, a South African healthcare company, and split the into a propco-opco structure.
Owned by: Netcare holds circa 53.7%, Apax Partners, circa 32.1%, and London & Regional circa 7.5%. The balance is held by management and senior staff.
Size: 69 hospitals and treatment centres across the UK
Turnover in FY2012: £834.1 million
EBITDAR in FY2012: £197.2 million

Stephen Collier, chief executive, BMI Healthcare

As the private hospital group with arguably the most to lose from the CC's investigation, BMI has fought its corner vigorously throughout the investigation. Like most of the big PHs, it says the CC has overstated its profitability and overlooked competitive barriers such as the high fixed costs for new entrants to set up, and the falling number of insured lives. It has also pointed the finger at the NHS and PMIs, whom it says hold most sway in price negotiations. The firm has experienced this first hand: Bupa delisted 37 of its hospitals – including "hospitals of concern" according to the CC's LOCI methodology – after a price dispute in 2011.

Chief executive Stephen Collier said: "We reject absolutely any assertion that BMI Healthcare and its hospitals exercise market power or that we make excess profits at the expense of patients. The vast majority of BMI's 69 facilities, in a UK market with over 500 rival facilities, face very significant local competition from other private hospitals and, increasingly, from the NHS."

Nuffield Health

Story: Nuffield has operated for more than 50 years and is one of the UK's largest charities. Its portfolio includes private hospitals, health clinics, fitness & wellbeing centres and diagnostic units.
Owned by: A registered charity
Size: 31 hospitals; 65 fitness & wellbeing centres; 39 medical centres; 200 on-site workplace fitness and wellbeing contracts.
Turnover FY 2012: £645 million
EBITDA FY 2012: £82 million

David Mobbs, chief executive, Nuffield Health

Nuffield has been one of the few hospital groups to openly criticise its peers, which it believes have constrained its growth through anti-competitive behaviour. Flagging BMI, HCA and Spire (but not Ramsay), it says large hospital operators with greater market power negotiate higher prices and near universal network approval with PMIs. This generates higher levels of ROCE, which its rivals then deploy to increase the leverage of 'must-have' hospitals during insurer negotiations. (The CC also says Nuffield's 'profitability' is far closer to the 'normal' rate than many competing hospital groups.)

Nuffield would be an obvious contender to pick up divested hospitals, and has welcomed the CC's report. But it'll be disappointed that it has not curbed the formation of consultant groups, which it says gives consultants market power over local hospital operators as well as patients.

Chief executive David Mobbs said: "The over-riding need for some providers to make huge profits at the expense of UK patients is clearly evident throughout the report. As the Competition Commission has recognised, as much as £190 million is being spent unnecessarily every year due to the market dominance of HCA, Spire and BMI, allowing them to drive up prices."

Ramsay Health Care


Jilll Watts, chief executive, Ramsay Health Care

Story: The Australian owned company entered the UK market in 2007, when it acquired Capio UK and its portfolio. The company has over 100 facilities worldwide, operating in Australia, the UK, France, Malaysia and Indonesia.
Owned by: Ramsay Health Care (publicly listed)
Size: 33 UK hospitals and day surgery facilities plus two neuro-rehabilitation homes.
Turnover in FY2012: £363.8 million
EBITDAR in FY2012: £91 million

With acute elective work for the NHS comprising a large proportion of its work (more than 65% of total UK admissions in 2012), Ramsay has criticised the CC for not focusing on the NHS as a source of competition. Aside from the NHS's numerous financial advantages and greater resources, NHS PPUs are also covered by PMI insurers and can have a "drag effect" on consultants, it has argued.

It criticised the CC's investigation for not focusing on day care, as only 27% of Ramsay's treatments are in-patient. It also says PMIs are too powerful, arguing that the 87% of premium revenue channelled through the four top PMIs in 2010 exceeds the market share of the top four grocery retailers in the UK by more than 20%. As a relatively new player, it added that it did not have local market power or influence over PMIs nationally.

Along with Nuffield, it has been spared any serious censure by the CC, and would be well placed to pick up divested assets from bigger groups. It has said little about the CC's findings other than to dispute claims it made above normal profits.

Bupa


Damien Marmion, managing director, Bupa Health Funding

Story: Set up in 1947, Bupa is the UK's biggest medical insurance provider, but also delivers a range of care services in international markets. It sold 25 of its UK private hospitals to Spire in 2007, but bought the Cromwell Hospital in London in 2008.
Owned by: The British United Provident Association
Size: 2.7 million UK customers for insurance and health and wellbeing services in 2012; plus a further 100,000 across its care and home healthcare and hospital services.
Turnover in FY2012: £2.5 billion
Profit in FY2012: £109.7 million

Bupa has always argued PMIs are in a weaker bargaining position in national price negotiations with insurers. It has been criticised for delisting hospitals (notably 37 of BMI's) but says it is very seldom that an insurer is in a position to do so. It also believes the longer and more public the "out of contract" situation, the more the PMI risks losing existing and prospective customers.

It will no doubt be delighted to see greater transparency around consultant incentives and says that a lack of comparable information has perpetuated the status quo.

It will also be pleased that its caps on insurer benefits have been spared – it claimed it had received "thousands of complaints" from policy holders about shortfall charges.

Its Open Referral policy also stands, too, despite complaints from hospitals that it restricts choice. But the CC has said it needs to ensure that policyholders are provided with clear and accurate information about consultants going forward. Dr Damien Marmion, managing director of Bupa Health Funding, said: "This is good news for patients and private healthcare... Millions of people with health insurance rightly expect high-quality healthcare for an affordable price."

AXA PPP

Keith Gibbs, chief executive, AXA PPP

Story: Part of France's Axa Group, AXA PPP Healthcare was created when AXA bought Guardian Royal Exchange in 1999, though it subsequently sold the other parts of GRE to Aegon. It is the second largest private medical insurer in the UK.
Owned by: Axa Group (publicly listed)
Size: Won't disclose customer volumes
Turnover in FY2012: £1.1 billion
EBITDA in FY2012: £69.8 million

AXA PPP has always accepted private medical insurers have power in negotiations, just not enough. It has argued it has little choice but to contract with the big private hospitals, and frequently comes under pressure to recognise all the hospitals within a certain hospital's group. Like Bupa it says delisting as a form of retaliation is financially risky. However Circle has criticised Axa for taking 21 months to recognise it when it set up in Bath.

Axa will welcome the CC's moves to create transparency around consultant shortfall fees, which it sees as a major source of customer dissatisfaction. It argues that capping does not suppress consultant fees below what would prevail in a competitive market, and denies it risks patients being directed to cheaper consultants. It will also be pleased that Open Referral is here to stay, arguing it reduces consultant dominance, especially where there is a limited number of specialists in a given area.

HCA International

Michael Neeb, president and CEO, HCA International

Story: The British arm of US-based HCA, HCA International operates the lion's share of London's major private hospitals.
Owned by: HCA Holdings (publicly listed)
Size: Six private hospitals, 18 outpatient and diagnostic centres and four NHS partnerships
Turnover in FY2011: £586 million
EBITDA in FY2011: Unknown

HCA's prominence in the London market was a particular cause for concern for the CC during its investigation. And the investigation has in turn been a cause for concern for HCA – indeed, one market source has said it could well lose two of its hospitals in London if a divestment goes ahead.

HCA has always argued that it has seen an impressive record of new entry and expansion in London, but also right across the UK – a trend it feels will continue. It has saved most of its ire for the "directional strategies" of PMIs, such as Bupa's Open Referral and AXA PPP's fixed fee schedule, which it says curbs choice and distorts supply.

It has also flagged NHS PPUs and charitable hospitals such as Nuffield (who get tax relief) as creating unfair competition in the market.

It also disagrees with the CC's assessment of its consumer market. As many patients in the London market are self-paid and hail from overseas, it has also argued that it must compete for patients with leading hospitals around the world, not just in the UK.

Commercial director Keith Biddlestone remains confident the CC will not go ahead with a divestiture when it publishes its final report in April 2014. "It's not in the consumers' interest to oblige us to sell these hospitals. We also think the CC will have to spell out the consumer detriment with 'conspicuous clarity', which they haven't done."