

# Executive Summary

## Background and Objectives

The Indian healthcare delivery market is estimated at US\$ 18.7 billion and employs over four million people, making it one of the largest service sectors in the economy today. Total national healthcare spending reached 5.2% of GDP, or US \$34.9 billion in 2004 and is expected to rise to 5.5% of GDP, or US \$60.9 billion by 2009. The sector comprises of many segments, which include hospitals, medical infrastructure, medical devices, clinical trials, outsourcing, telemedicine, and health insurance, to name some. The industry has grown at about 13 per cent annually in recent years and is expected to grow at 15 per cent per year over the next four to five years. According to a recent study, the industry will account for 6.1 percent of GDP by 2012 and is projected to provide employment to around 9 million people.<sup>1</sup>

A striking feature of India's healthcare system is the significant and growing role of the private sector in healthcare delivery and total healthcare expenditures. Public health expenditure accounts for less than 1 percent of GDP compared to 3 percent of GDP for developing countries and 5 percent for high income countries. The private healthcare sector in India accounts for over 75 percent of total healthcare expenditure in the country and is one of the largest in the world.

India's healthcare sector, however, falls well below international benchmarks for physical infrastructure and manpower, and even falls below the standards existing in comparable developing countries. It is estimated that over a million beds have to be added to attain this 1.85 ratio, which translates into a total investment of \$78 billion (Rs. 350,830 crores) in health infrastructure. An additional 800,000 physicians are required over the next 10 years, which translates into huge investments in training facilities and equipment. In order to reach even 50-75 percent of the present levels of other developing countries, the sector will require an estimated investment of \$20-30 billion.<sup>2</sup> Thus, India's healthcare sector needs to scale up considerably in terms of the availability and quality of its physical infrastructure as well as human resources.

Given the growing demand, the emergence of reputed private players, and the huge investment needs in the healthcare sector, in recent years, there has been growing interest among foreign players and non resident Indians to enter the Indian healthcare market. There is also growing interest among domestic and international financial institutions, private equity funds, venture capitalists, and banks to explore investment opportunities across a wide range of segments. This study examines the status of foreign financing (foreign direct investment-FDI as well as other forms of foreign fund inflows) in one of the key segments of the healthcare sector, i.e., in hospitals. It also analyses the implications of such financing for the hospital segment and for the overall healthcare system.

The specific objectives of the study include:

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<sup>1</sup> These statistics are taken from IBEF, available at [www.ibef.org](http://www.ibef.org)

<sup>2</sup> See, Ernst and Young (2007) and CRISIL Research (Feb 2007).

- (a) Understanding the nature of foreign funding in hospitals in India, as well as other forms of foreign involvement (not necessarily financing related) in the hospitals segment in India;
- (b) Understanding the institutional and other factors facilitating and impeding foreign funding in hospitals in India; and
- (c) Understanding the realized or likely impact of foreign investment in hospitals in India on various aspects of the healthcare sector and the wider economy (quality, affordability, infrastructure development, technology, accessibility, prices, etc.)

In addition to the aforementioned objectives, this study aims to provide policy inputs that would facilitate such investments and enable the realization of the greatest possible benefit from such inflows. It also aims to inform policy makers with regard to India's commitments in health services for the mode of commercial presence (mode 3) under the General Agreement on Trade in Services (GATS) negotiations in the WTO.

## Methodology and scope

The study is based on primary as well as secondary research. The primary research has been conducted in *two parts*. One part was outsourced AC Nielsen, which carried out its survey work in two phases. The first phase of the primary research consisted of administering a structured questionnaire to administrators and finance sections of 19 hospitals in 6 cities around the country. All the hospitals were of a minimum size of 100 beds, multi-specialty, and included a mix of for profit private hospitals with and without foreign financing and not for profit private hospitals categorized as charitable/trust hospitals. The second phase of the survey work by Nielsen consisted of 15 semi-structured interviews with various stakeholders (doctors, nurses, owners or managers of hospitals and nursing homes (large and mid size) health consultants, health insurance companies, diagnostics, and medical equipment suppliers and patients. The second part of the primary research was undertaken by the author. This consisted of 30 in-depth discussions with senior management in major corporate hospitals and with other stakeholders such as civil society organizations, industry associations, financiers, doctors, and public sector practitioners across three cities.

## Status and prospects for foreign investment in hospitals in India

The study indicates that the foreign investment policy is very liberal for hospitals. Since January 2000, FDI is permitted up to 100 percent under the automatic route in hospitals in India.<sup>3</sup> Controlling stake is also permitted in hospitals for foreign investors. FIPB approval is only required for foreign investors with prior technical collaboration, but allowed upto 100 percent. Current regulations also permit other forms of capital mobilization, such as through ADRs and GDRs, upto 49 percent, which are treated as FDI. FII as well as private equity funding over a certain stake are also permitted under FDI route. In addition, FIIs and private equity funds can individually purchase upto 10 percent and collectively upto 24 percent of the paid-up share capital of the company, through open offers or private placement, or through the stock exchange. Proprietary funds, foreign individuals and foreign corporates can register as a sub-account and invest through the FII, subject to limits of 10 percent and 5 percent, respectively for these sub-accounts. Foreign venture capital investments (FVCIs) are also permitted, though subject to certain restrictions. No major regulatory

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<sup>3</sup> See, RBI note on Foreign Investments in India (April 1, 2007).

hurdles seem to exist with regard to the setting up of hospitals. Although various forms of financing may be classified as FDI, industry experts distinguish between these various modes as they have different implications for the absorption of costs, benefits to patients, expectations of returns, and improved capacity in healthcare delivery.

An examination of the list of approved hospital projects obtained from the Department for Industrial Policy and Promotion and the primary survey indicates that despite the liberal regulatory environment, FDI presence in Indian hospitals is very limited at present. There are only three or hospitals which according to industry persons, qualify as FDI hospitals in India. The rest are FDI approved on paper, and may not have brought in capital. There are also players who have routed funds through other countries but do not see themselves as FDI hospitals as this routing is only for tax purposes and not really FDI type inflows. However, it is perceived that there will be increased inflow of foreign funds into India's hospital segment in the near future given major expansion plans by existing and prospective corporate players. These include huge Medicities with large super-speciality and multi-speciality hospitals and integrated healthcare services as well as scaling up of existing operations and setting up of new hospitals around the country. Much of the recent capital inflows have been through private equity funds and IPOs and this trend is expected to continue. However, the predominant mode of financing is domestic borrowing and foreign financing constitutes roughly 20 percent of funding in hospitals.

## Constraints to foreign investment in hospitals in India

While there are clearly many drivers to foreign investment in hospitals in India, the study finds that there are external as well as domestic constraints, which explain the limited presence of foreign investment in India's hospital segment. These constraints include the fact that the number of such foreign players may be limited, there are competing investment destinations, there are difficulties for foreign players in entering independently and in maintaining joint ventures that the gestation period in hospital projects is long and that investors may not be willing to make such a long term commitment. More importantly, various domestic factors adversely affect the returns to investment in hospitals in India. These include high initial establishment costs and in particular the prohibitive cost of procuring land, low health insurance penetration in the country which reduces the consumer base for corporate hospitals, restrictions on medical education and training providers which create a supply bottleneck and adversely affects the quality of medical personnel at all levels, the high cost of importing medical devices and the limited domestic manufacturing capacity in this area, other regulatory deficiencies which result in lack of standardization, proper governance, and quality assurance in the healthcare sector, and lack of policy clarity and priority to the healthcare sector. Thus clearly, unless such constraints are addressed, a liberal investment

## Impact of foreign investment in hospitals in India

Overall, if one were to take the survey results as reflecting the way in which foreign funded hospitals function compare to non foreign funded hospitals, and thus the kind of impact they are likely to have on the healthcare sector, then several insights emerge.

- Such hospitals are likely to focus on more advanced procedures and specialty areas.
- They are more likely to focus on curative and intervention oriented treatment than on preventive and long-term kind of treatment.

- They are likely to employ a higher ratio of technology to personnel in their healthcare delivery and thus involve a substitution of human resources with technology and equipment.
- They are likely to invest much more in medical equipment and devices and also in specialized and experienced medical personnel, thus involving a focus on high-end human resources and high-end technology.
- Such hospitals tend to have better systems and processes and usage of IT, which creates a more efficient and professional work environment.
- Foreign funded hospitals pay higher rates to staff at all levels and particularly to senior medical personnel.
- They are more likely to attract overseas doctors and specialists than other hospitals
- They are more likely to be accredited domestically and/or internationally.
- Their costs are likely to be comparable to or slightly higher than those of non foreign funded large hospitals
- Their costs will tend to be higher than for small and medium size nursing homes and hospitals but this is mainly due to greater capital intensity and focus on quality systems and processes and focus on hygiene
- There could be positive externalities in other areas, some of which could further drive foreign investment in hospitals
- Foreign funded hospitals could draw away medical personnel at all levels from other hospitals (both large non-foreign-funded and medium and small size hospitals/nursing homes, and public sector hospitals) and could adversely impact the quality of medical manpower available to competing institutions
- There is likely to be closure of substandard institutions, some consolidation of the hospital segment, and new kinds of arrangements could emerge between larger and smaller players as the healthcare sector evolves
- There could be greater segmentation between the public and private sector with resource flows towards the latter, greater wage disparity, unless innovative arrangements emerge between the two segments and reforms are undertaken in the public sector hospitals

While there are clearly concerns about the equity, affordability, and market segmentation implications of growing foreign investor presence in India's hospital segment, it is evident that the root cause lies in structural problems that are already present in the healthcare sector, such as lack of affordable health insurance schemes or inappropriate regulations on medical education providers. Foreign investment and greater corporate presence in hospitals could aggravate such structural problems. The insights obtained from the discussions with stakeholders suggest that the solution lies in strengthening the public healthcare system, in amending certain regulations that affect all players, and in introducing schemes, which provide affordable access to healthcare for all and not in restricting foreign investment. The benefits of foreign investment in hospitals are likely to outweigh these adverse effects.

## Implications for GATS commitments in hospital services

The study examined whether India should further liberalize its offer on hospital services to 100 percent with no prior approval requirement, i.e., bind in its existing FDI regulations in this area? The findings of this study suggest that India could bind in its existing FDI policy in hospitals and permit 100 percent on automatic route. The justifications for such a strategy relate to two facts. First, as investors see a lack of clarity and roadmap for the health sector, a binding commitment would signal that the liberal foreign investment policy for hospitals is there to stay and that the government is committed to facilitating investments in India's hospital segment. Second, to the extent that additional FDI does flow into hospitals, there are several likely benefits that could accrue while the negatives that could arise will not really be a direct result of foreign investment but of existing structural distortions and inadequacies in India's health care sector.

The study also suggests possible conditions that could be inscribed in India's commitments to ensure that certain objectives are realized. The existing revised offer puts a technology transfer related condition. Another possible condition could pertain to corporate social responsibility measures, such as outreach and extension services and reinvestment of part of profits in medical research and education or in telemedicine to serve a wider population base if any subsidies or concessions have been granted in related areas. While other conditions could be inscribed, such as requiring tie ups with local players in terms of referral services, education and training of personnel, transfer of older equipment, and pooling of resources, it may not be advisable to impose too many conditions as these could adversely affect incentives for investors and their bottomlines. But the study notes that a liberal binding commitment on FDI in hospitals may not translate into greater foreign investment in India's hospitals unless the various constraints affecting hospital projects are addressed. Thus, a more reform oriented approach and a shift in attitude would be required in various areas, including in public sector institutions, in medical education, health insurance, the medical equipment and devices segment, and infrastructure facilitation, among others. Such supporting measures and reforms would help ensure the benefits while mitigating the possible negatives. Also, negotiators need to look at India's commitments and domestic policies in other sectors, such as in health insurance and higher education, at their commitments in other modes and sub sectors of health services, and keep in mind the impact of cross cutting regulations.

## Policy recommendations

Overall, the study throws up several policy measures required by government and initiatives required by private players to make the hospital segment more attractive to both domestic and foreign investors if the ultimate aim is to expand capacity, improve standards, and make healthcare affordable and accessible to a wider segment. Some of these measures include:

- Facilitating land acquisition- some subsidization of initial project costs or PPP arrangements with possible cost discounting or cross subsidization arrangements built into the valuation of land;
- Consider other forms of obtaining land- through leasing arrangements, joint development with real estate developers and arrangements with public sector units owning land and hospital facilities and government facilitation of such arrangements;
- Freeing up medical education and encouraging private hospitals to enter into medical education and training to expand the supply of medical personnel at all levels

- Incentivising domestic manufacturing of medical devices and technologies through increased investment in this sector and tie ups with foreign companies and efforts to standardize output
- Opening up the health insurance sector to enable greater scrutiny of processes and standards of hospitals, which would also help attract foreign funds, as well as introduction of a national or community based health insurance scheme to increase affordability of healthcare and mitigate potential adverse effects of corporatisation on equity;
- Improving the regulatory framework for health insurance by standardizing norms for payouts, coverage, reduce malpractice;
- Facilitating public private partnerships in hospitals, with private sector hospitals entering into limited period management contracts with public hospitals, under well-defined revenue sharing arrangement, along with CSR responsibilities through cross subsidization mechanisms
- Greater sharing of resources (equipment, knowledge, research facilities) between public and private hospitals and between larger private hospitals and smaller local players
- Establishing a regulatory framework and an independent regulator in the healthcare sector to address issues of standardization, classification, information disclosure, etc.; and
- Improved regulation and monitoring of mid and small size establishments to improve standards and quality, weed out substandard establishments, and enable consolidation in healthcare delivery.

Perhaps the most important point illustrated by this study is that mere liberalization of the foreign investment regime without putting in place supporting institutional and regulatory frameworks and domestic reforms, will have limited effectiveness. Foreign investment can yield many benefits but if structural and regulatory deficiencies are not addressed, these benefits may not materialize and existing structural distortions may be aggravated. Hence, government needs to take a proactive role by initiating domestic reforms and creating an enabling environment so that the benefits of liberalization do ensue and any adverse effects are mitigated.