



Nortons Inc
ATTORNEYS AT LAW

WHO/OECD Seminar: Netcare Presentation
30 August 2016

AGENDA

- 1 Presentation Overview**
- 2 WHO/OECD paper does not assess competitive conditions in SA private health sector**
- 3 Direct evidence and market place conditions show SA's private hospital sector is conducive to competition**
- 4 On an objective basis, SA prices are neither high nor excessive**
- 5 Several methodological and empirical issues with WHO/OECD price analysis**
- 6 Price Regulation in private funded and privately delivered healthcare is inappropriate and is likely to be unsustainable**



Overview of Presentation

- **WHO/OECD paper is in essence a study relating to “affordability” of private healthcare relative to the entire South African (“SA”) population (including for people who are unemployed).**
- **WHO/OECD paper does not assess competitive conditions in SA’s private healthcare sector or perform a cost-based analysis of private hospital prices.**
- **Direct evidence and marketplace conditions show that conditions in the private hospital sector are conducive to effective competition.**
- **There are several methodological and empirical issues with WHO/OECD price analyses.**



Overview of Presentation cont.

- **On an objective basis, SA private hospital prices are not excessive nor high nor indicative of the need for price regulation.**
- **Affordability measures conflate public policy and competition policy concepts and do not indicate that SA private hospital prices are too high or that price regulation is optimal policy.**
- **Price regulation can be costly with uncertain benefits relative to competition, have unintended consequences, and unsuitable for addressing equity concerns.**
- **Recommended price regulation likely results in an unsustainable private sector.**



Premise of OECD Affordability Study

- **The authors draw inferences from price level comparisons and inflation analyses about the private health care sector in SA that conflate public policy and competition policy concerns.**
 - The authors assess the “affordability” of private hospital services to the general population given the estimated price levels, rather than evaluating price levels or price inflation compared to some measure of economic costs.
 - OECD thesis appears to be that private healthcare prices should reflect or be in sync with income levels in a particular country.
 - This approach takes no account of economic cost i.e. the economic cost of rendering the services to patients.
 - OECD approach suggests that private hospital prices should be adjusted to be in line with income levels even if this means private healthcare providers make a substantial loss.
- **This approach is not consistent with competition law jurisprudence or accepted economic principles or practice in assessing whether prices are too high.**



WHO/OECD Paper Does Not Assess Competitive Conditions in SA's Private Healthcare Sector nor Cost-based Reasons for Prices

- **The WHO/OECD paper does not address competition issues relevant to the inquiry into the private healthcare sector in SA, nor does it make use of standard competition methodologies.**
 - Accepted methodologies for evaluating competition issues, including prices are:
 - » assessing the reasonableness of prices taking into account economic costs and other factors; evaluation of whether prices or profits are excessive; and/or
 - » assessing competitive conditions including competitive alternatives, entry and expansion, and competitive interactions between suppliers and purchasers.
 - There is precedent in SA regarding price and profitability analyses: in *Mittal Steel South Africa vs Harmony Gold Mining Company* the Competition Appeal Court stated that demonstrating 'excessive pricing' requires: (i) the determination of the 'economic value' (i.e. the economic cost); and (ii) if the actual price is higher than the economic value of the good or service, is the difference "unreasonable"? Similar reasoning in the *Sasol* case.
- **The HMI identified several potentially relevant competition considerations for investigation: Adequacy and coherence of current healthcare regulatory framework; information constraints faced by consumers; and potential market power of funders and providers. (Revised Statement of Issues (2016))**



WHO/OECD Paper Does Not Assess Competitive Conditions in SA's Private Healthcare Sector nor Cost-based Reasons for Prices

- **The WHO/OECD paper does not undertake any costing analyses or economic analyses of cost in evaluating prices or in drawing inferences of alleged “excessive” or “high prices.**
 - No reference to or without any context of the economic costs associated with private healthcare delivery in SA or in any of the comparator countries.
 - Any indirect references to costs implicitly recognise that costs are highly relevant, yet defers analysis to a future date: e.g., “future work may carve out “pharmaceuticals” from the hospital component as **pharmacy costs make up a significant part of hospital costs.** [emphasis added] (footnote 13 of the WP)



WHO/OECD Paper Does Not Assess Competitive Conditions in SA's Private Healthcare Sector or Cost-based Reasons for Prices

- **The WHO/OECD paper does not undertake any traditional competition analyses; nor does it examine prices in the context of the customers who utilise private hospital services in SA:**
 - Competition analysis focuses on the customers for the relevant products (demand side) – which in this instance are the customers for private healthcare and hospital services. Customers in SA include medical schemes operating on behalf of consumers and consumers with private health insurance obtaining services from private hospitals.
 - The WHO/OECD paper does not evaluate marketplace competition and negotiations between medical schemes and private hospitals in SA for provision of services to these consumers, nor the costs of delivering hospital services in the private sector.
 - The WHO/OECD paper fails to establish “like-for-like” comparators for these SA consumers and for the private healthcare delivery system when it undertakes the comparative price analyses – its benchmarks include countries with virtually no private sectors, and those with largely public funding of private and public hospital services, and the entire populations of countries
- **Accordingly, the WHO/OECD paper does not engage with what is necessary methodologically, theoretically, or empirically to address the competition considerations which may be of relevance for the HMI.**



Direct Evidence and Marketplace Conditions Show that Conditions are Conducive to Effective Competition

- **Expert reports submitted by Netcare reported on extensive analyses of competitive conditions and competition using traditional and well-accepted methods including:**
 - Market definition, structural and competitor analyses in local geographic areas, and assessment of entry and expansion by hospitals and consideration of the diversity of competitors, and responsiveness of entry to market conditions and demands
 - Price-concentration analyses
 - Bargaining analyses and evaluation of contracting and negotiations between medical schemes and private hospitals
 - Profitability analyses
- **These analyses and the resulting direct evidence of competition and marketplace conditions that are conducive to effective competition refute the hypothesis that price regulation is required.**



Direct Evidence and Marketplace Conditions Show that Conditions are Conducive to Effective Competition: Geographic Area/Entry

To assist the HMI in its evaluation of market conditions and the competitiveness of the private hospital structure, we provided analyses of geographic areas and entry and expansion:

- **Analyses of Structure and Competitive Alternatives:** We used standard methods and data for defining market areas and identifying competitors for each of the Netcare hospitals as well as for 15 larger geographic areas (e.g., metro areas such as Johannesburg). For each area, we created analyses of the competitive structure and identified the number of and identity of competitors and the number of hospitals and beds. These showed the majority of areas have numerous competing alternatives. (At hospitals where Netcare earns 95% of revenue Netcare hospitals face between 3 to 5 competitors per facility.)
- **Markets are not static in South Africa:** Detailed entry and expansion analyses on a area-by-area based revealed competitive dynamics with ongoing further de-concentration with expansion by over 51 hospitals and 29 new entrants.



Direct Evidence and Marketplace Conditions Show that Conditions are Conducive to Effective Competition: Price/Bargaining

Additional empirical analyses were conducted of price-concentration and bargaining to inform the HMI – these also refute concerns about market power or competition issues.

- **Price-Concentration** analyses showed no evidence of local market concentration causing local prices to be higher across Netcare’s portfolio of full* hospitals.
 - At the scheme level: very little to no variation in prices across geographic markets.
 - At the hospital level: no relationship between local market concentration and (i) average (over schemes) tariff level, or (ii) revenue per admission (even controlling, to the extent possible, for patient acuity).
- **Bargaining** analyses illustrate competitive pressures and that Netcare does not have market power over negotiators that account for the majority of its revenues; and that medical schemes have demonstrated their ability to counteract alleged bargaining power.
- **Hearing testimony is consistent:** e.g., Discovery Health reports that it has "*been able to contain hospital costs and cost per event pretty much at CPI for the last many years.*" Dr. Jonathan Broomberg (Discovery Health CEO) during public hearings. (See page 82 of transcript available on the HMI website.)

* Hospitals that provide services in multiple diagnostic categories, offer a wide range of services, and where patients tend to stay overnight.



Direct Evidence and Marketplace Conditions Show that Conditions are Conducive to Effective Competition cont.: Profitability

Actual assessment of costs and profitability reject any inference of any excess profitability. Direct analyses of costs and profitability were provided in the FTI (Harman) Reports using accepted methods.

- A detailed analysis and comparison of Netcare's Hospital Business' economic costs and prices – using a number of different approaches, and over different time periods – revealed that the business' profitability and hence prices are not excessive or indeed above what one would expect in a competitive and sustainable market.
- Indeed, “it is only when prices across a market significantly and persistently exceed total economic cost that one can make a finding of excessive prices. As the OECD Report does not make any such assessment I find that the analysis contained within the OECD Report does not support a conclusion that private hospital prices in South Africa are high from an economic or competition perspective. As illustrated in my previous reports, I have assessed Netcare's prices and economic costs in detail and found no evidence that prices are high.”(Response of Greg Harman to the OECD Report May 2016, par. 1.12, pg. 4-5)



Direct Evidence and Marketplace Conditions Show that Conditions are Conducive to Effective Competition

Market definition, structural and competitor analyses, and entry and expansion

- Comprehensive assessment by geographic area using standard methods demonstrates there are numerous competitive alternatives in local geographies with an array of services and facilities, and substantial entry (29 hospitals) and expansion by 51 hospitals into geographies that is further deconcentrating and responsive to local needs.

Price-Concentration Analyses

- Sound econometric analyses provides Price-Concentration analyses that showed no evidence of local market concentration causing local prices to be higher across Netcare's portfolio of full hospitals.

Bargaining analyses

- Analyses including evaluation of contracting and negotiations between medical schemes and private hospitals provide detailed and practical information on competitive interaction. Bargaining analyses illustrated that Netcare does not have problematic degree of market power over negotiators that account for majority of its revenues and medical schemes have strategies to counteract any alleged bargaining power.

Price, Cost and Profitability Analyses

- Empirical analyses of costs, prices, and factors affecting profitability were combined and presented using standard methodologies tested in economic and competition contexts. Assessment of costs and profitability reject inference of any excess profitability. Indeed, prices are not above what would be expected to prevail in a competitive and sustainable market.

On An Objective Basis, SA Prices are Not High nor Excessive nor Indicative of a Need for Price Regulation: Price Levels

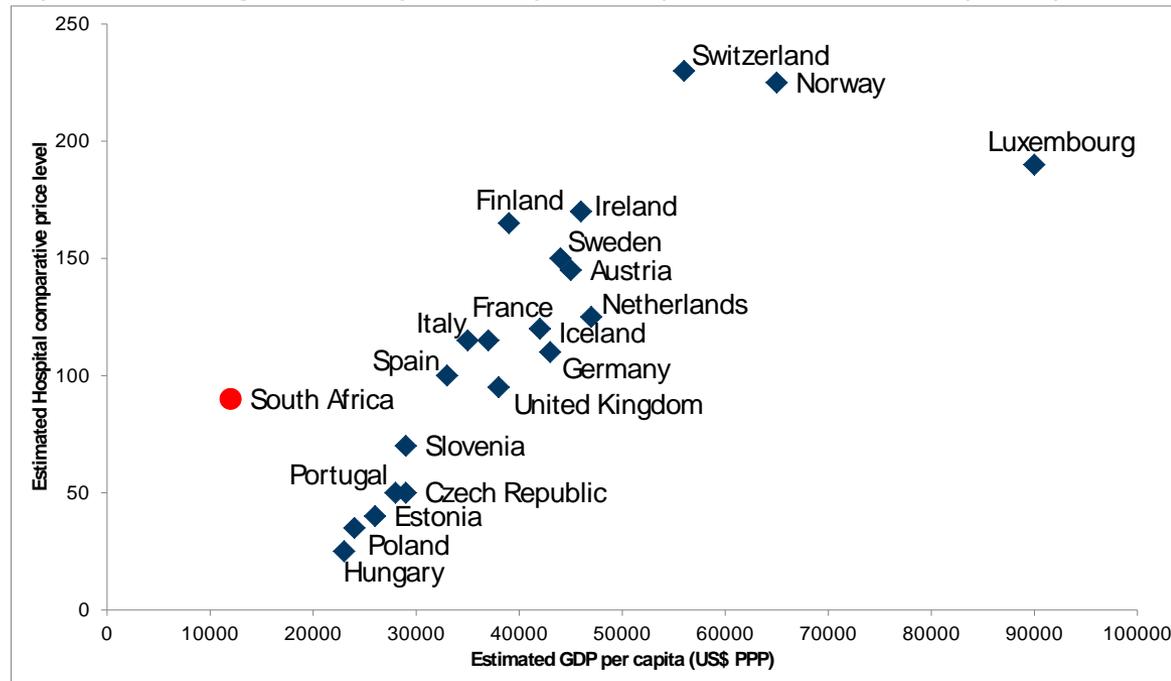
We conducted economic and empirical evaluation of the WHO/OECD prices and price analyses

- The price level comparisons and inflation measures do not support a conclusion that average prices in South Africa are excessive, non-competitive, or well above some measure of cost, nor that they are increasing at a high rate of inflation relative to medical and input costs generally or as compared to rates of increase of hospital inflation in OECD countries.
- On the assumption that the price level calculations as reliable: On a price comparison basis, without reference to country income or GDP, the calculated South African prices for the common market basket of hospital services are at the lower end of OECD country prices.
 - If the sole purpose of the study had been to replicate the OECD price analyses and to attempt an “apples-to-apples” comparison of hospital prices (assuming that one was able to be done), the WHO/OECD study does not indicate any basis for concern about South Africa’s price levels on a pure price comparison basis.
- Analysis in Ms. Guerin-Calvert’s Report (23 May 2016) showed that 14 OECD countries have prices that exceed those of South Africa (see next slide): these include countries with a wide range of public and private systems, and with widely varying mix of public and private funding.

On An Objective Basis, SA Prices are Not High nor Excessive nor Indicative of a Need for Price Regulation cont.: Price Levels

- The WHO/OECD response in fact concludes that SA's private prices are at the average for OECD public/private prices and below those of many OECD countries. This is depicted graphically in the Response's Figure 3, which also shows the considerable variation in calculated prices among these 14 OECD countries.

Replication of Figure 3. Hospital comparative price levels and GDP per capita, 2013



On An Objective Basis, SA Prices are Not High nor Excessive nor Indicative of a Need for Price Regulation cont.: Price Levels

- **There were only 6 countries with lower public (predominantly) prices than SA's (private hospital prices) (Czech Republic, Estonia, Hungary, Poland, Portugal, and Slovenia); these were used as benchmarks for comparison with South Africa based on income levels. However, the OECD #75 paper identifies several issues that affect both the reliability of these countries' price estimates and especially their use as comparators:**
 - **Public vs. private hospitals**
 - **Deficits**
 - **Data issues**
 - **Exclusion of large informal payments and out-of-pocket payments**
- **These limitations imply estimated prices for these 6 countries are likely to be artificially low and/or reflect systems not in equilibrium and/or in need of upward adjustment.**



On An Objective Basis, SA Prices are Not High nor Excessive nor Indicative of a Need for Price Regulation (cont'd): Correlation

- **The WHO/OECD paper presents correlation analyses to predict price levels for South Africa. Correlation analysis, however, does not provide a sound or reliable prediction of where South Africa's prices should be from a competitive or cost basis:**
 - There is no causal relationship between a country's income level and costs/prices for hospital services; it is not a simple and linear relationship, and correlation analysis ignores the economic costs of delivery of healthcare services
 - There is no basis for assuming that private hospital systems in South Africa could sustain themselves at this lower level of prices – in fact, as discussed below, the private hospital sector likely would not be sustainable at these price levels.
- **The WHO/OECD paper fails to focus on the relevant customer group in South Africa in its benchmarking and pricing analyses – those utilising the private hospital sector.**



On An Objective Basis, SA Prices are Not High nor Excessive nor Indicative of a Need for Price Regulation (cont'd): Inflation

- The inflation measures do not support a conclusion that average prices in South Africa are excessive, non-competitive, or well above some measure of cost or increasing at some high rate of inflation relative to medical and input costs either generally or as compared to rates of increase of hospital inflation in OECD countries. Prices are not increasing at an unusual or high rate as measured by commonly used price indices.
- Because of the focus on “affordability” and comparison with consumer-based measures of inflation, the paper inappropriately uses headline inflation or CPI as the measure against which to evaluate estimated South African hospital price increases. This does not measure cost inflation using common measures utilized by governments or academics to measure medical inflation.
- Indeed, the authors of the OECD #75 Paper caution against using general inflation as a measure for evaluating underlying cost trends in hospital services due to the substantial differences in cost drivers for hospital services, which tend to increase at rates above general CPI.



On An Objective Basis, SA Prices are Not High nor Excessive nor Indicative of a Need for Price Regulation (cont'd): Inflation

- **The price index customarily used by many countries (including South Africa) to measure medical inflation is the Medical CPI, which typically increases at higher rate than general inflation due to its components (medical technology, labour, pharmaceuticals, and other healthcare inputs).**
- **Headline CPI as a benchmark for hospital price increases is poor measure of healthcare costs**
- **Empirical analyses show South African estimated prices (accepting them as reliable) are increasing at rates consistent with medical inflation and not far above headline inflation. The reported WHO/OECD price inflation analyses do not support the conclusion that prices are increasing at a “high” rate, and thus do not implicate competitive concerns or the need for price regulation.**



Methodological and Empirical Issues with WHO/OECD Price Analyses

- **The WHO/OECD construction of estimated prices in SA faces several issues that are not addressed adequately in the recent response or in the original paper. These issues raise substantial concerns about the comparability of the estimated SA prices with OECD prices, and particularly about the reliability of SA price data for any use by the HMI in pricing analysis of SA hospitals.**
- **We note at the outset that the WHO/OECD did not provide the data and supporting information to enable the HMI or participants in the process to: (1) validate any of the data and information, (2) assess thoroughly the representativeness and sample biases, or (3) to undertake any sensitivity analyses of the estimated prices or the analyses.**
- **While review of the reported results has enabled us to identify a number of important methodological issues and data issues, we would require substantial time to thoroughly vet the actual data to evaluate the nature and extent of any other issues and to evaluate the quality of price data and analyses.**



Methodological and Empirical Issues with WHO/OECD Price Analyses Render the Price Data, Benchmarks and Inferences Unreliable

Incorrect Measure of Price Inflation

- The appropriate measure of healthcare inflation is a medical CPI not headline CPI. WHO/OECD do not address key drivers of hospital costs, (medical, pharmaceutical). Also includes the costs of specialists and does not account for factors that may cause prices to increase, or increase more rapidly.

Inappropriate benchmarks for comparisons between South Africa and OECD countries

- There are many issues with the chosen benchmarks that undermine ability to make any price comparisons: (1) compares SA private sector with public/private or public in other countries; (2) no controls on costs or reimbursement; (3) different systems of private insurance and reliance by customers on private insurance and (4) many countries may operate in deficit or may subsidize costs for consumers or for hospitals.

Lack of representativeness and stability of the sample

- Data appears to represent only a small proportion of the relevant population; no means to demonstrate it is a representative sample of the true population; or comparable sample to OECD samples; price results suggest that unknown factors may be driving price differences.

Invalid price comparisons for procedures or across countries

- Unclear whether data were adequately weighted for demographics or other characteristics, and whether important differences in input costs (e.g., pharma, technology, specialists) were accounted for; no means to compare samples within South Africa or between countries.

LOS (Length of Stay)

- WHO/OECD draw inferences about potentially poor quality of care from LOS metrics that may suffer from substantial data issues; lower LOS may not be indicator of poor quality.

Price Regulation is Not Typical for Private Healthcare Sector

- **The WHO/OECD paper does not make an economic case for price regulation. It substantially overstates the extent to which there is regulation of price negotiations between private medical schemes and private hospitals.**
 - Our research does not find support for a broad role for price regulation of the private sector including private hospitals and private insurers in OECD countries.
 - A centrally-administered pricing process is not characteristic of the private healthcare sector in most OECD countries, and only rarely are prices for private healthcare to privately insured patients regulated.
- **It is important to distinguish between regulating private prices negotiated between private healthcare insurers and private providers, and governments setting the price for publicly funded healthcare.**
 - In many healthcare care systems around the world, the government is the primary purchaser of healthcare services for the population or for certain segments of the population (for example, as Medicare and Medicaid in the United States). In those cases, it must have a method for determining the prices it is willing to pay for those services (whether the services are obtained in public or private hospitals). This is different than price regulation of private sector prices.
 - It also may be the case that these reimbursements are below some measure of cost and that private hospitals need to seek higher reimbursements from private insurers or sustain losses.



Price Regulation is Not Typical for Private Healthcare Sector

- A recent OECD working paper states that government price regulation is not the common practice in countries that are similar to South Africa:

“None of the eight countries where private health insurance plays a similar role to that in South Africa (Australia, Finland, Ireland, Italy, New Zealand, Portugal, Spain and the United Kingdom) directly intervened to regulate prices of medical services settled between private health insurers and private hospitals. Recognising the role of private health insurance as a voluntary product for those with the capacity and willingness to pay for additional services, the scope of regulation is focused on assuring the financial position of private health insurers (prudential regulation) and reducing scope for some consumers to face discrimination in accessing insurance products.” (See, Kumar et al., "Pricing and competition in Specialist Medical Services: An Overview for South Africa," OECD Health Working Papers, par. 12, 13.) Regulation, instead, may focus on mitigating some other issues such as equity issues and risks.

- Review of historical and empirical studies of price regulation in the United States largely showed that competition tends to produce superior results to regulation.



Price Regulation Can Be Costly and Have Unintended Consequences

The UK's Competition and Markets Authority conducted an extensive investigation of the UK's private healthcare sector, examining privately-funded health insurers and privately-funded healthcare services providers. In its final report, it cautioned against a regulatory solution of price regulation:

- “We were concerned that, given the large number of different treatments and procedures in existence, a price control regime would be very difficult and costly to set up in this market (whether in the form of a reference tariff or by comparison to charges levied by similar hospitals) and to update, to take account of both the introduction of new treatments and procedures, and movements in costs over time.
- We were also concerned that price controls may be vulnerable to circumvention, in that hospitals subject to such a cap would be incentivised to reduce the quality of the service they provide.
- Further, we thought that the existence of price caps may generate distortion risks over time by discouraging innovation and the introduction of new and better treatments and procedures. They would also discourage new entry into an area subject to a capping regime, unless the potential new entrant could be certain that the fact of its entry would result in the removal of price caps in that area.
- There is at present no private healthcare industry regulator and the imposition of this remedy would require one to be created to administer and update the price-capping regime and adjudicate on disputes.
- We considered that, while price caps might appear to address the immediate customer detriment in single hospital areas, the cost of setting up and administering such a regime would be considerable and, over time, would result in customer detriment through distortions creating lower quality of service and reduced innovation.
- **We therefore decided that a price-capping regime would not be effective in the long term, and would not be proportionate.”**



The WHO/OECD Recommended Price Regulation Would Likely Result in Substantial Losses for Private Hospitals

- **The FTI Report by Greg Harman conducted high level empirical analyses of the effect of the hypothetical recommended price regulation, using sound cost and revenue estimates and plausible assumptions. The WHO/OECD Paper does not provide any analysis of the potential effects of the recommended regulation.**
- **The results show that the regulated prices as suggested by the OECD Report would lead to significant losses for Netcare.**
- **The FTI Report also concludes that this suggests that price regulation, as suggested by the OECD Report, would significantly damage the sustainability of the private hospital market in South Africa.”**



Recommended Price Regulation Likely Results in Substantial Losses

- The FTI Report adjusts Netcare's FY 2014 and FY 2015 revenues to approximate price levels of the hypothetical recommended price regulation.
- This *very significant* reduction in Netcare's revenue results in, all other things (including costs) being equal, Netcare incurring losses that amount to billions of Rands per year for FY 2014 and FY 2015.
- On the assumption that patients remain constant, and that drugs, surgicals and nursing costs, etc. comprise approximately 80% of costs, the analysis finds it is hard to extract sufficient savings to compensate for the loss of revenue.
- In fact, the FTI analysis shows that even allowing for significant cost reductions to accompany the hypothetical reduction in revenues would not be sufficient to break-even (let alone return a profit).



Recommended Price Regulation Likely Results in Substantial Losses

- **The FTI analysis concludes that the recommended price regulation likely results in substantial losses and solvency issues for the private healthcare sector.**
- **Using publicly available data the report also finds that other providers would make losses of comparable magnitude (to the hypothetical scenario discussed above) if their revenues are adjusted according to the recommended price regulation.**
- **The report concludes that this would severely threaten the sustainability of the private hospital industry in SA and potentially affect international investment in other industries (for fear of losing investments due to regulatory intervention).**



Summary of Conclusions: SA Prices are Not Excessive or High or Indicative of a Need for Price Regulation

- **The WHO/OECD paper does not examine competition for private healthcare; nor has it applied standard principles of competition economics, including evaluation of economic costs, profitability and drivers of prices. The paper does not provide an assessment of whether there are competition concerns in SA.**
- **An assessment of whether competition is working includes direct and indirect evidence of competition – and the direct evidence (as set out in our submissions) on competition between private hospitals shows that it is strong.**



Summary of Conclusions: SA Prices are Not Excessive or High or Indicative of a Need for Price Regulation cont.

- Taking the WHO/OECD price level comparisons and inflation measures as given, and reviewing them objectively, they do not support a conclusion that average prices in South Africa are excessive, non-competitive, or well above some measure of cost or at increasing at some high rate of inflation relative to medical and input costs generally or as compared to prices or rates of increase of hospital inflation in OECD countries.
- Nor do they support the conclusion that price regulation is required to supplant market-based negotiations between medical schemes and private hospitals in South Africa.
- Price regulation is unnecessary given the workable competition associated with private negotiations. It will not address public policy challenges raised by the WHO/OECD paper.
- The implied reductions are very likely to have substantial and adverse “unintended” consequences, including making private hospital operations uneconomic, causing substantial financial losses and reduced ability to sustain or grow hospital services and facilities to meet needs. Moreover, other regulators have rejected price regulations as very costly to implement with the potential for adverse consequences.



Summary of Conclusions: SA Prices are Not Excessive or High or Indicative of a Need for Price Regulation cont.

- In consideration of affordability: The price level analyses when combined with the income and GDP levels illustrate a public policy challenge not a competition policy challenge
 - Providing healthcare to the entire population in SA through the existing private hospitals may be “unaffordable” and SA may face substantial challenges in providing access in the public and private sectors at heavily subsidized rates given the substantial proportion of population that is lower income or unemployed.
 - Different ways of delivering and/or subsidizing the cost of healthcare or health insurance may be needed to provide greater access or affordability
- All of the foregoing assumed there were no issues with the WHO/OECD price levels analyses:
 - There are, however, numerous technical, methodological, and empirical flaws that remain even after the authors’ responses.
 - We caution that these methodological and empirical flaws make the data unreliable, particularly for consideration of the need for price regulation or for the evaluation of pricing and the competitiveness of the private healthcare sector.

